ADMINISTRATION'S VIEWS ON THE DEFICIT AND POSSIBLE REVENUE INCREASES FOR THE NEXT 3 FISCAL YEARS

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

FIRST SESSION

TESTIMONY OF HON. DONALD T. REGAN, SECRETARY OF THE TREASURY

JUNE 14, 1983

Serial 98-28

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE
24-538 O WASHINGTON : 1983

H781-9

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J. J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY H. (PETE) STARK, California
JAMES R. JONES, Oklahoma
ANDY JACOBS, JR., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
CECIL (CEC) HEFTEL, Hawaii
WYCHE FOWLER, JR., Georgia
FRANK J. GUARINI, New Jersey
JAMES M. SHANNON, Massachusetts
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
KENT HANCE, Texas
ROBERT T. MATSUI, California
BERYL ANTHONY, JR., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut

BARBER B. CONABLE, JR., New York
JOHN J. DUNCAN, Tennessee
BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
JAMES G. MARTIN, North Carolina
RICHARD T. SCHULZE, Pennsylvania
BILL GRADISON, Ohio
W. HENSON MOORE, Louisiana
CARROLL A. CAMPBELL, JR.,
South Carolina
WILLIAM M. THOMAS, California

JOHN J. SALMON, *Chief Counsel*
JOSEPH K. DOWLEY, *Assistant Chief Counsel*
ROBERT J. LEONARD, *Chief Tax Counsel*
A. L. SINGLETON, *Minority Chief of Staff*

ADMINISTRATION'S VIEWS ON THE DEFICIT AND POSSIBLE REVENUE INCREASES FOR THE NEXT 3 FISCAL YEARS

TUESDAY, JUNE 14, 1983

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 11:05 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Dan Rostenkowski (chairman of the committee) presiding.

[The press release announcing the hearing follows:]

[Press release of Tuesday, June 7, 1983]

HON. DAN ROSTENKOWSKI (D., Ill.), Chairman, Committee on Ways and Means, Announces That Hon. Donald T. Regan, Secretary of the Treasury, Will Appear on June 14, 1983, To PRESENT THE ADMINISTRATION'S VIEWS ON THE DEFICIT AND POSSIBLE REVENUE INCREASES FOR THE NEXT 3 FISCAL YEARS

The Honorable Dan Rostenkowski (D., Ill.), Chairman, Committee on Ways and Means, U.S. House of Representatives, announced today the Honorable Donald T. Regan, Secretary of the Treasury, will testify on the Administration's current views with respect to the need for revenue increases for fiscal years 1984, 1985, and 1986. This hearing will be held on Tuesday, June 14, 1983, beginning at 11:00 a.m. in the Committee's main hearing room, 1100 Longworth House Office Building.

The purpose of the hearing is to establish the Administration's latest position on mounting U.S. deficits, the effect of these deficits on economic recovery over the next three years, increasing taxes as a means to reduce deficits (with specific reference to the President's contingency tax), the disparity between inflation and real interest rates and the global economic concerns expressed by our allies at the recent summit meeting.

Under recent Office of Management and Budget estimates, published in April, 1983, current services deficits will be $226.1 billion for fiscal year 1934,, $241.6 billion for 1985, and $260.1 billion for 1986. Congressional Budget Office baseline projections for the same periods are $197 billion for fiscal year 1984, $214 billion for fiscal year 1985, and $231 billion for fiscal year 1986.

In the Administration's original budget submission of February, 1983, the President proposed two new contingency taxes: first, an excise tax of $5 per barrel on domestic and imported oil; and second, a 5-percent income tax surcharge on individuals and corporations. Under the Administration's proposal, both contingency taxes would become effective only if three conditions are met: (1) Congress adopts the Administration's proposed spending reductions and structural changes in Federal entitlement programs; (2) the Administration forecasts on July 1, 1985, that the Fiscal Year 1986 unified budget deficit will exceed 2-½ percent of the gross national product; and (3) the economy is growing on July 1, 1985. The Administration proposed that these contingency taxes be enacted in 1983 effective on October 1, 1985, and lasting up to three years.

Chairman ROSTENKOWSKI. The committee will come to order.

Mr. Secretary, it has been more than a year since you have come before this committee to explain and defend the administration's

economic policies. A lot has happened in that time on both the economic and political fronts, yet the frustration and anxiety of producing a rational economic plan for the country has changed very little.

Deficit levels that seemed unimaginable 2 or 3 years ago are at hand. Both the administration and Congress have agreed that $200 billion in deficits are a grim reality as far as the eye can see unless we can agree on a balanced plan to reduce them.

Mr. Secretary, political gamesmanship is a fact of life in Washington. Each legislative calendar is bracketed by national elections, but the reality of more than $1 trillion in deficits over the next 4 years must overtake the increasingly bitter political maneuvering if we are to steadily emerge from this prolonged recession.

The global economic consequences of carrying a debt that large, of having to borrow that much money will be, I am sure you will agree, catastrophic. The tentative signs that economic recovery is spreading are welcome, certainly by no one more than me. But sustaining recovery against $200 billion deficits is like trying to walk up a down escalator, and that dilemma provides the purpose of today's hearings.

We would like today to establish the administration's position on mounting deficits, the effect of these deficits on economic recovery over the next 3 years, and the role that revenue increases might play in their reduction. We are all familiar with the general administration strategy that spending cuts must carry the charge on the deficit, backed up with a contingency tax.

I would say that the majority among us in Congress is very concerned and recognize that any balanced economic plan must include spending cuts as well as tax increases. Most important to us today are your thoughts on the specific revenue approaches, both their timing and substance, that could lead to a more even trend in Federal budgeting.

Unless we can temper our political rhetoric and get down to the basic clinical approaches of controlling out-year deficits, we will together forfeit the confidence of this country and ultimately sink the economy in debt.

Mr. Secretary, my colleagues and I would hope that our discussion today will be the starting point for a united strategy to reset the Nation's economic course.

Mr. Secretary, I welcome you. As has been our custom, I hope that the hearings today will be fruitful. At the conclusion of these hearings I hope that we can set forth on a constructive policy together.

Mr. Conable is recognized.

Mr. CONABLE. Thank you, Mr. Chairman.

Welcome to the committee, Secretary Regan. It is nice to have you back.

A press release announcing today's hearings indicated the subject of the hearing was to obtain the administration's views on the deficit and possible revenue increases of the next 3 fiscal years. I would like to compliment the chairman on the statesmanlike opening remarks that he has made.

It has been widely reported in the press that the intended focus of the hearings is to consider the proposal to cap out at the $700

per person the third year of the rate reductions enacted by the Economic Recovery Tax Act. It has been further reported that Speaker O'Neill has promised the Senate he would send them a bill before the end of the month with a cap proposal attached to it.

I must say that this method of legislating demeans the dignity of the committee as a serious legislative forum, and I am reassured by the chairman's not having referred to it. I hope we can keep the discussion on the level of his opening statement. I do reserve the right to speak further about the $700 cap if it emerges in the discussion as a possible subject for action at this time.

Chairman ROSTENKOWSKI. Mr. Secretary, welcome to the committee. The committee is ready to receive your testimony.

STATEMENT OF HON. DONALD T. REGAN, SECRETARY OF THE TREASURY

Secretary REGAN. Thank you, Mr. Chairman and members of the committee. It is a pleasure to meet with you today to discuss the administration's position on the budget deficit and how that position affects our tax policy objectives.

First, let me put the budget picture in perspective by looking at the current state of the economy. For the near term, at least, it now appears that our last economic forecast submitted to Congress in April was a bit too conservative. We predicted that real GNP would grow at an annual rate of 4.9 percent during the current quarter, and it now appears that the economy will grow at a faster rate.

There are other positive signs that the recovery is progressing well. The index of leading indicators has risen in each of the last 10 months, and retail sales are up. Real wages are increasing, and unemployment is decreasing, although not at a fast enough rate as yet. It is of the greatest importance that we not jeopardize this recovery by tax increases now.

The good news about the second quarter is one sign that the policies we put in place over 2 years ago are working. However, we recognize that with the ongoing recovery and its beneficial effects of helping to lower the forecast of deficits, we will still have significant long-term budget deficits.

I, for one, do not believe deficits are caused because taxpayers do not pay enough taxes. The long-term deficits exist because Government spending has grown a lot more rapidly than receipts over the last 20 years. Government spending as a percent of GNP is now running above 25 percent this year, and will remain above 24 percent in 1984.

By comparison, spending levels in the 1970's averaged less than 21 percent. Taxes are now about 19 percent of gross national product, approximately the same level as in the 1970's. These trends clearly underscore the fact that the problem is one of overspending and not undertaxing.

In the fall of 1980, the American public gave this administration a clear mandate to reduce the size of government, because the public correctly perceives the deficit problem as a spending problem and not as a tax problem. This fact makes it all the more important to enact the President's proposed budget.

Long-term deficits remain a concern. They may not prevent recovery, but they will dampen the long-term rate of growth. They could prevent interest rates from dropping, and they could reduce investment. It is because of the problems associated with substantial long-term deficits that we continue to suggest a contingency tax plan for fiscal years 1986 through 1988.

The President's contingency tax plan, an insurance policy for the economy, is a plan for fiscal responsibility. If Congress ducks this responsibility entrusted in them by the electorate, if there is no plan or commitment to reduce the long-term deficit, then the conditions necessary for sound and orderly long-term financial and economic health will be replaced by uncertainty and doubt on the part of individuals and businesses alike.

The deficit must be attacked through a balanced program of growth, revenues, and spending reductions. However, we cannot have enactment of the contingency tax plan until Congress first adopts spending cuts such as the President has proposed. We do not intend that the contingency tax revenues be used to finance more Government spending. Instead, they must be used to reduce our debt.

Further, the contingency taxes will not take effect until fiscal 1986. Any tax increase before then, particularly any limitation on the third year of the tax cut, would be the wrong medicine for the economy.

As I have mentioned, the rebound from the recession has clearly begun. It is not just the administration, but a broad majority of economists and businessmen who read the current statistics as evidence that the recession has ended. Although these signs represent very good and encouraging news, we still have a long way to go for full recovery.

As we are all painfully aware, unemployment remains over 10 percent. Our Nation's factories are still operating at only 71.1 percent of capacity. The level of real output is still no higher than it was at the end of 1979. This is not yet a sufficiently vigorous economy that we can risk reducing consumer confidence by raising taxes. Indeed, the full third year of the President's tax cut will be just the impetus that consumers need to maintain and invigorate the recovery.

Just as bad as the ill-advised timing of a limit on the third year tax cut, limiting the benefits from the third year of the rate reduction would impair the vitality of the economy in the long run. That would permanently retain in the tax structure some of the disincentives to work and save that the 1981 Economic Recovery Tax Act [ERTA], removed.

Across-the-board marginal rate cuts for all is what is needed to stimulate the savings in the work effort that will cause our country to avoid the slow growth and declining productivity of the last decade.

The President's policies must not be reversed just as the recovery is clearly under way. The third year of the tax cuts enacted under ERTA, restraint in Government spending and the assurance of a marked downward trend in deficits in the 1986–88 period are needed now as much as they ever were. Any divergence from this plan could upset the process that is just beginning to work.

In addition to proposals to cap the tax cut, suggestions have been made which I know will be made again to prevent tax indexing from taking effect in 1985 as current law requires. Repeal or postponement of indexing would be a most irresponsible budget policy. Indexing simply keeps the Government from profiting from inflation. It stands in the path of the big spenders who would like to have taxes continue to grow faster than income, and to do so automatically.

Indexing insures that if Congress tries to increase spending, they will have to raise the required revenues by voting on new taxes, and not simply by accepting the combination of inflation and inaction. Our success in reducing inflation should never be taken for granted. Surely we should not return to a system that rewards inflationary policies with automatic tax rate increases.

Further, the repeal of indexing will increase the relative tax burden on the lowest income taxpayers. For example, if indexing is repealed and inflation is 4.5 percent, those earning less than $10,000 will have their taxes increased by 9.4 percent, while those earning more than $100,000 will have their taxes increased by only 1.1 percent.

Seventy-eight percent of the entire revenue gain from repeal of indexing will be borne by those earning less than $50,000.

And now, turning to proposals to cap the third year of the tax cut, as I have stated, a tax increase this year or next would be particularly harmful to the economic recovery now taking place. Because there has been well publicized discussion of the notion that capping the third year of the tax cuts is good policy, I would like to take this opportunity to correct several misunderstandings as to what such a policy would do.

Proponents of a cap apparently wish to make people believe that a cap on the third year will make the rich and only the rich pay more taxes. This notion is simply not true. A $700 limit on the amount of the tax reduction will hit squarely at our great middle income class. The truth is that just about half of the 8 million returns that would be affected by a $700 cap are filed by single individuals and married couples earning less than $50,000.

Mr. Chairman, as you can see from this chart, of the total number of returns affected, a little over 8 million, 48 percent—nearly 4 million returns—are below the $50,000 income level; 9 percent of those affected are returns above $100,000 and 43 percent are in the bracket between $50,000 and $100,000. Some single taxpayers who do not itemize deductions will be affected, even though they earn no more than $30,000 of gross revenue.

Based on our estimates, a $700 cap would increase taxes for 8.1 million tax returns, an average of $654, but the unfair impact of a cap on middle-income families and single individuals is perhaps most clearly illustrated by example. Each of the examples I am providing is for people who will be earning the average wage for their profession in 1984.

My first example, Mr. Chairman, a married couple consisting of a police officer, earning $23,260, and a registered nurse earning $20,960, would have received a tax reduction in 1984 of $917 if they did not itemize their deductions. Instead, the cap will result in a

loss of $197 that they would otherwise spend on consumption or save.

It is ironic that the $197 tax increase over current law roughly offsets 30 percent of the $691 tax benefit from the 10 percent second earner deduction that Congress enacted to help maintain incentives for the two-earner family.

My next example, Mr. Chairman, is a secretary earning $13,950, married to a chemical engineer earning $36,120. They jointly have a 1984 tax reduction of $1,179, if the couple did not itemize deductions. The cap would cut this reduction back by $459. If the couple did itemize an average amount of deductions on their tax return, then the cutback in their scheduled tax reduction would be smaller, but it would still amount to a tax hike of $134, compared with current law.

My third example, two public school teachers, each earning $20,670. They would have $83 lopped off their tax reduction.

My fourth example, a single person earning $32,500 as a sales manager, or even as a GS–12 Federal Government worker, who does not itemize deductions, would have his 1984 tax cut pared back by $108.

I want to stress that each of these examples is based on the average earnings of each occupation given. Please note in these examples how much of this proposal hits at families with working spouses. We have prided ourselves over the past two decades at finding jobs for the second worker, and in the 1981 tax law, we tried to even things out for married workers. Now this proposal will undo much of that. That is not progress. That is retrogression.

Also, I would like to point out that imposing a cap on the third year is not a simple matter of placing a limitation on tax refunds. A cap would affect taxpayers on withholding, taxpayers making estimated tax payments, taxpayers with end-of-year refunds, and taxpayers making end-of-year final tax payments. A cap on the tax cut therefore requires revising each of the tax rate schedules that apply to single individuals, married couples filing jointly, married people filing separate returns, and heads of households.

As you can see from the examples I have just cited, because of the need to round the tax rates to the nearest whole percent, the actual cap for joint returns is $720. A similar technical problem exists for single returns. In order to have the cap apply at the same place on the single person's rate schedule as it applies on the joint return rates, the cap for single people works out to be $637.

That is, since the $700 cap first affects the joint rates at the 33-percent bracket, a comparable cap for singles would first affect their rates at the 34-percent bracket rate. The capped tax rate schedules that would remain permanently in the tax law would be sharply more progressive throughout their middle ranges than current law rates. This is because a capped rate schedule must rise quickly at the point the cap applies in order to limit tax reductions to about $700.

This increased steepness in the marginal rates would apply initially only to the upper middle incomes, but as the whole distribution of income gradually moves upward over time, it would not be long before the vast range of middle-income taxpayers became subject to the same highly progressive tax rates.

As this final chart, Mr. Chairman, shows, under current law, when taxable income on a joint return reaches $35,200, there is a 5-percent jump in the marginal tax rates from 28 to 33; under a capped rate schedule, this becomes a nine-point jump in marginal tax rates, from 28 percent paid on income just under $35,200 to 37 percent paid on the first dollar of income just above that level.

That chart also illustrates the fact that a capped rate schedule would have joint returns reaching the top 50-percent rate two brackets sooner than under the current law. Not only would many average working families and individuals in a host of professions feel the pinch of the cap, but the $700 tax cut ceiling would also affect scheduled rate reductions for small business.

Small businesses, which are a vital source of employment and investment, are almost always taxed at the individual income tax rates. Only 14 percent of all small businesses pay the corporation income tax. The remaining 86 percent are partnerships, sole proprietorships, or small corporations electing to be taxed as individuals and pay only the individual income tax.

Overall, nearly 2½ million small businesses, including 350,000 family farms, would have their taxes increased by a $700 cap. You realize, of course, Mr. Chairman, that farmers will be adversely affected by this proposal, yet we all know the difficulties that farmers are having and what it is costing in Federal revenues to alleviate their current problems.

While it is true that almost half of our taxpayers who would be hit by a $700 cap earn less than $50,000, it is also true that those with the very highest earnings will lose a relatively small part of their overall 3-year tax cuts. This is because the top rate was reduced from 70 percent to 50 percent all at once, on January 1, 1982.

A crucial element of the President's tax program has been the reduction in marginal tax rates so as to encourage work and savings. Overall, the tax cut program will reduce marginal rates by about 25 percent. Marginal rates have been cut 15 percent thus far, and the remaining 10-percent cut will come on July 2. If the third-year tax cut is capped, however, all of the third-year's reduction in marginal rates will be repealed for many taxpayers. If the third phase is now capped at $700, joint returns reporting taxable incomes between $35,200 and $45,800 will have received a reduction in the marginal rates of tax they pay equal only to 14 percent instead of 23.3 percent.

For those with taxable incomes between $45,800 and $109,400, the marginal tax rate reductions would range from 14.3 percent up to 15.3 percent, if the third year is capped, as opposed to reductions of 22.4 percent up to 23.7 percent if there is no cap.

Looking at this over a period of years, there will be some families and single individuals who will receive no reduction in their marginal tax rates at all. One example, a family of four with one wage earner who had income in 1980 of $40,000 paid tax at the 37 percent marginal tax rate in 1980. If their income remains constant in real terms, that is, the wage earner receives a cost of living wage increase but nothing more, this family would be paying taxes in 1984 at a marginal rate of 33 percent under current law.

24-538 O - 83 - 2

If the third year is capped at $700, however, they will be paying tax at exactly the same 37-percent marginal tax rate that they faced in 1980, before all three phases of the tax cut were enacted. So, this cap wipes out all the gain there was in a lowered marginal rate.

What happens, Mr. Chairman, to the American dream of the middle class under this proposal? As I have shown you by a few examples, those who are trying to get ahead by having two workers in the family to pay for a better house or educating children are to be penalized by ill-conceived tax legislation. There is no use trying to earn more. Congress will tax it away. That's not fair to the middle class. That is not "soak the rich." It is drown the middle class.

In conclusion, I urge this committee to reject the proposal. It is bad economics, bad tax policy. It hits hardest at working spouses, and it is simply unfair. However, Mr. Chairman, I do stand ready to work with you and with this committee to achieve reductions in the Federal deficit.

This administration welcomes your suggestions on how we can meet the problems of the out year deficits and where the reductions can be made. Our motivation in preparing a contingency tax was to show the American people that if we were to ask them to provide additional revenues for reducing deficits, so, too, would we ask the Congress to join us in making reductions.

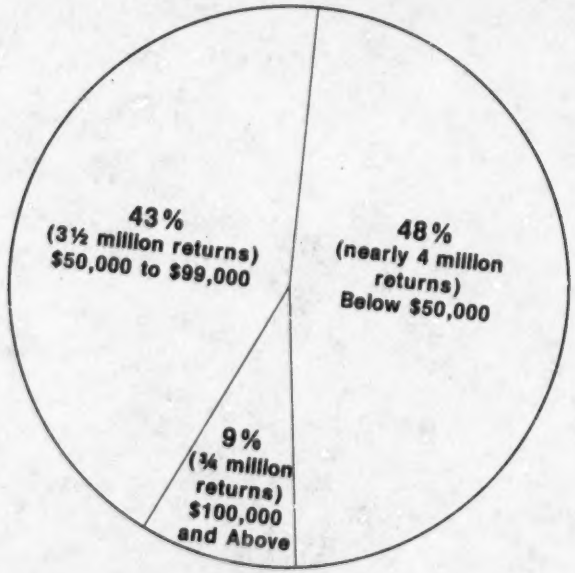
There are no easy solutions, but I am confident we can meet this challenge.

Thank you, Mr. Chairman.

[The charts referred to follow:]

Chart 1

DISTRIBUTION BY INCOME CLASS OF TAXPAYERS AFFECTED BY THE CAP



Source: U.S. Treasury
June 14, 1983

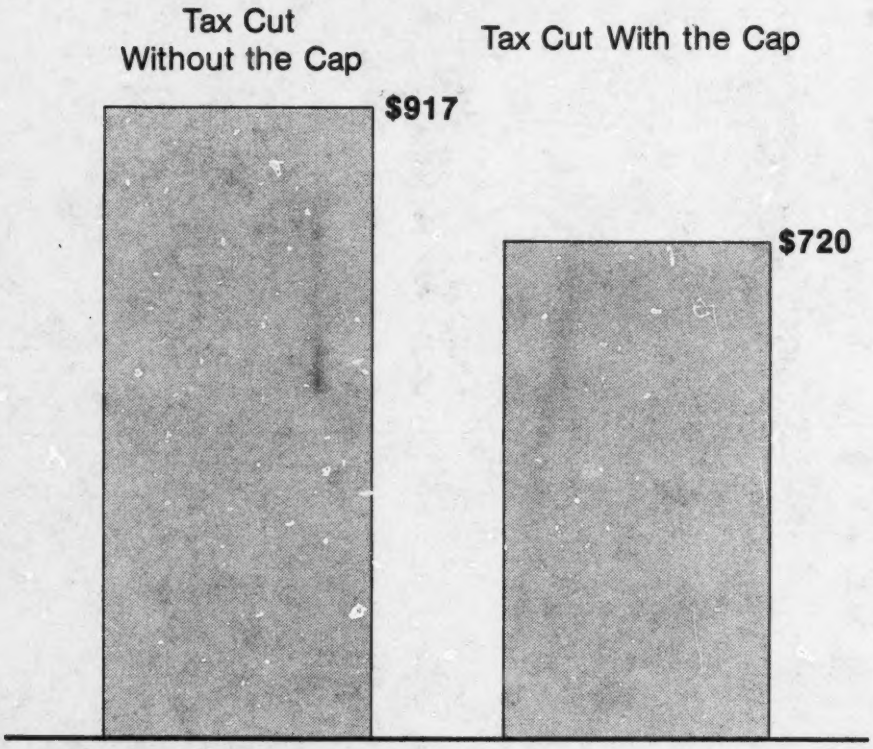
Chart 2

Example 1

Married Couple

Occupation	Annual Income*
Police Officer	$23,260
Nurse	$20,960
Family Income	$44,220

Third-Year Tax Cut in 1984**



*Incomes shown are estimated average 1984 earnings for full-time workers in the occupations listed.

**Assumes no itemized deductions.

Source: U.S. Treasury
June 14, 1983

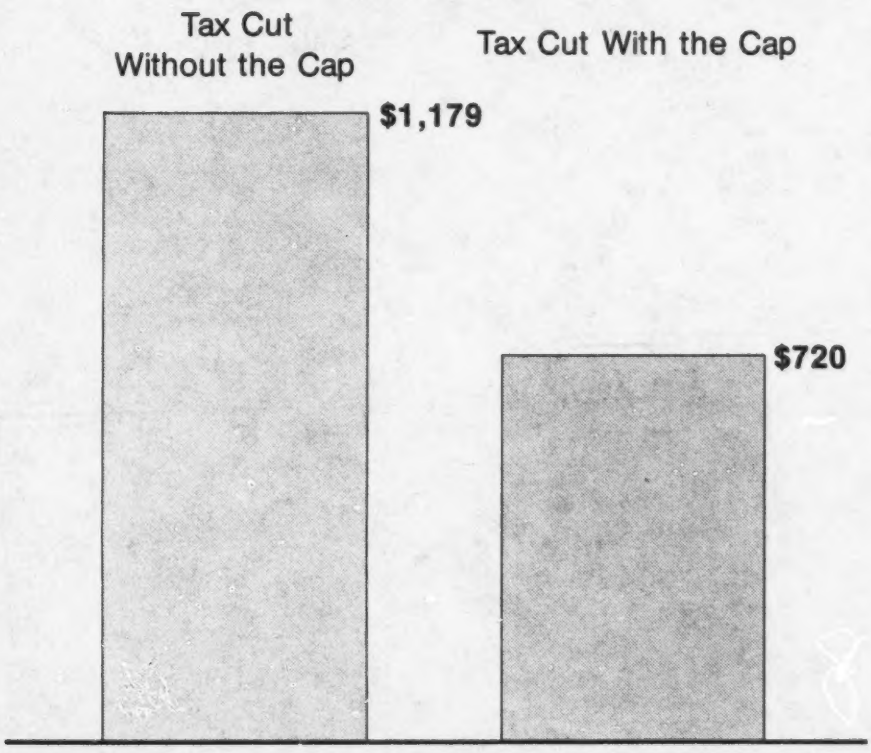
Chart 3

Example 2

Married Couple

Occupation	Annual Income*
Secretary	$13,950
Chemical Engineer	$36,120
Family Income	$50,070

Third-Year Tax Cut in 1984**



*Incomes shown are estimated average 1984 earnings for full-time workers in the occupatins listed.

**Assumes no itemized deductions.

Source: U.S. Treasury
June 14, 1983

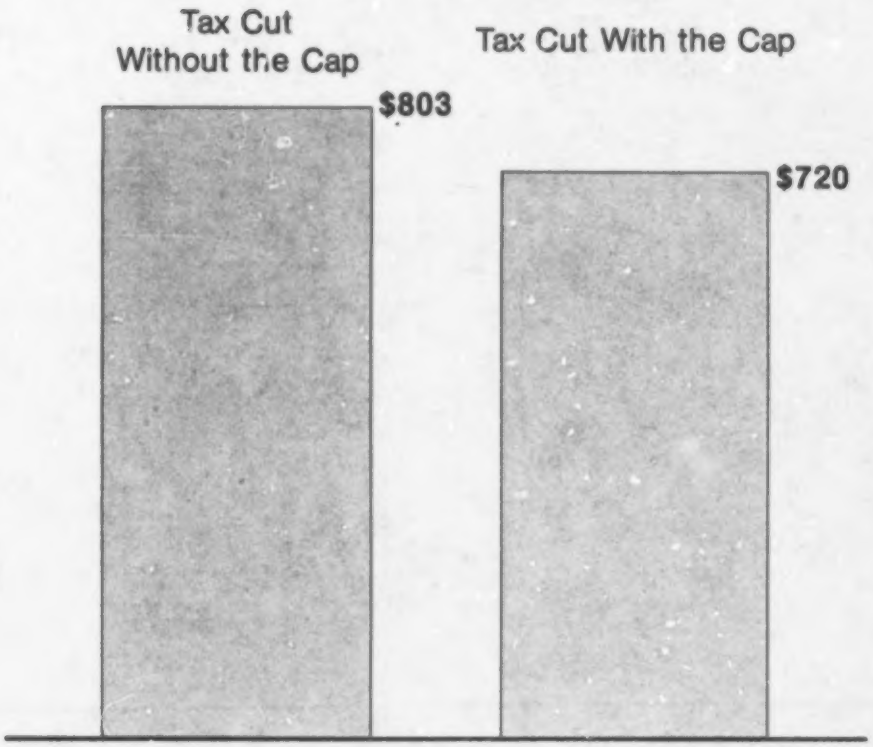
Chart 4

Example 3

Married Couple

Occupation	Annual Income*
School Teacher	$20,670
School Teacher	$20,670
Family Income	$41,340

Third-Year Tax Cut in 1984**



*Incomes shown are estimated average 1984 earnings for full-time workers in the occupations listed.

**Assumes no itemized deductions.

Source: U.S. Treasury
June 14, 1983

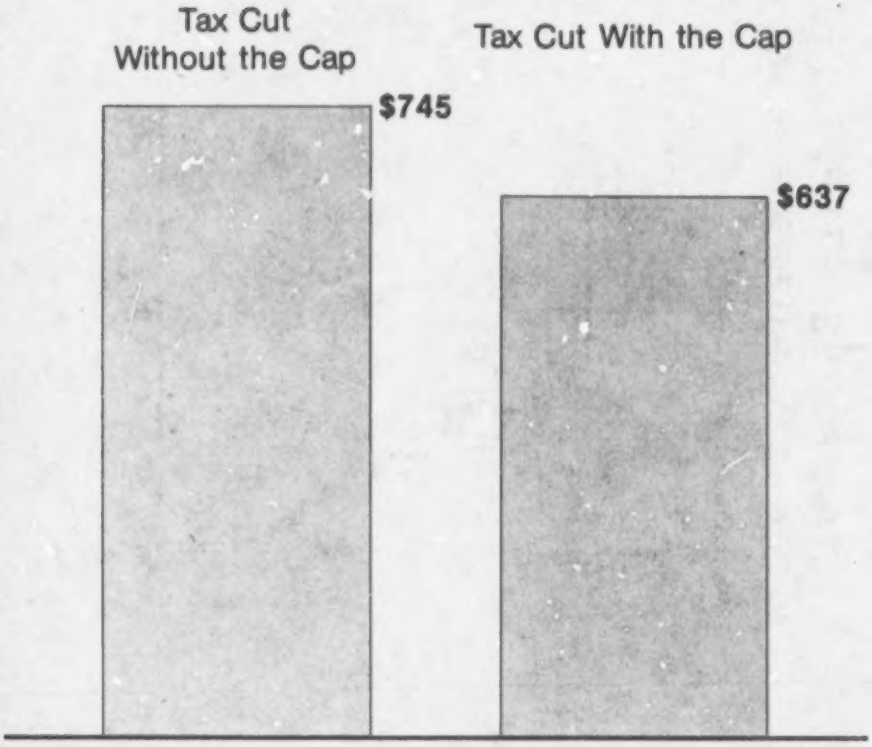
Chart 5

Example 4

Single Individual

Occupation	Annual Income*
Sales Manager or GS-12 Government Worker	$32,500

Third-Year Tax Cut in 1984**



*Income shown is estimated average 1984 earnings for full-time worker in the occupation listed.

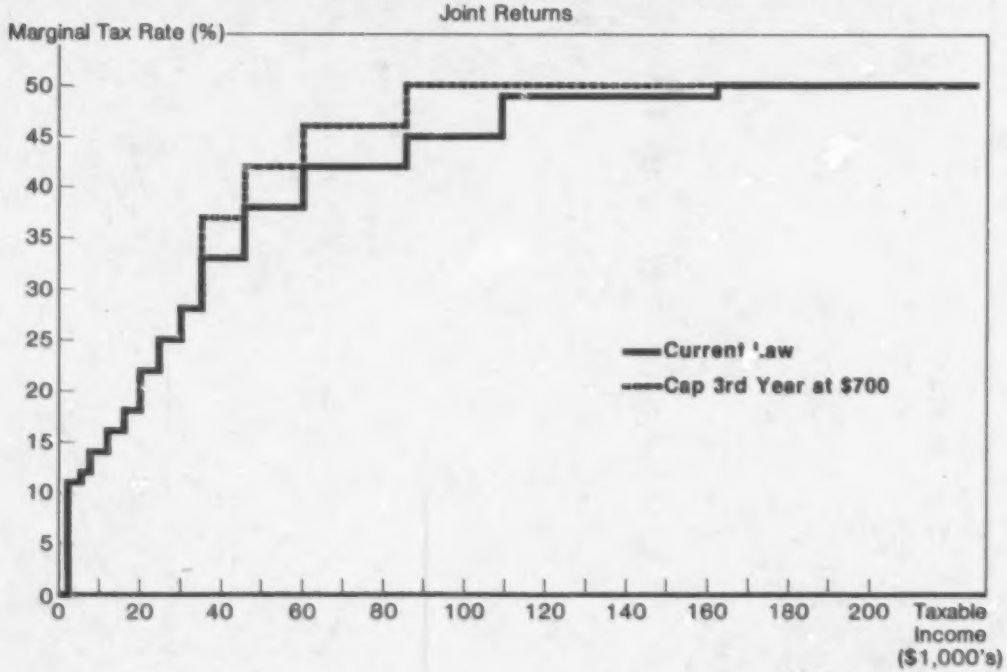
**Assumes no itemized deductions.

Source: U.S. Treasury
June 14, 1983

Chart 6

TAX RATES: STEEPER, HIGHER, EARLIER

MARGINAL TAX RATES BEFORE AND AFTER THIRD YEAR CAP



Source: U.S. Treasury
June 14, 1983

Chairman ROSTENKOWSKI. Thank you, Mr. Secretary.

Mr. Secretary, some economists, including some of your former colleagues, with whom I visited last week on Wall Street, are now taking the position that while the 25-percent individual tax cut might have been excessive, it would be equally imprudent to restrict it now, because of the recovery which they feel is showing signs of being underway.

Yet the same economists have said to me that it makes no sense to wait until fiscal year 1986 to begin meaningful improvements in our revenue base. Mr. Secretary, reasonable men differ on how to generate additional revenue. However, do you still believe that it is inappropriate for us to begin to restore the revenue base?

Secretary REGAN. Mr. Chairman, I do, and I will tell you why. As I said in my prepared remarks, this economy is still fragile. We have not locked up the recovery by any means as yet. It could falter. It has done that before when least expected by economists and by others. We think that to have tax increases over the next 2 years would be folly, because it is not needed at this point. The deficits can be handled.

However, as the recovery continues, as there is more demand on the part of the private sector for capital, as the savings pool remains the same—it doesn't increase that much because of consumption—then there will be this battle between the Treasury and the private sector for what is available in the capital pool.

At that point, I think instead of borrowing, it would be wise that we tax, if those deficits still remain large out there, and if in the meantime, we have been able to achieve some downward path in deficits by cutting spending in the out years.

Chairman ROSTENKOWSKI. Mr. Secretary, you are aware of the cautious attitude of Members of Congress, my colleagues on both the majority and minority side, with respect to whether or not we should impose a cap on the third year tax cut, and with respect to whether or not we should walk the same path together, and engage in a full-scale discussion as to where revenues can be increased.

I was quite concerned with some of the attitudes of members of your former financial community who talked about the need for courageous steps to raise revenues. If we do not start in that direction, deficits will not come down. In the next 4 or 5 years, can we expect an additional $1 trillion in deficits?

Until such time as we agree upon a coordinated effort—and I know that we are entering the highest political theater in the next 18 or 19 months—but unless we make that effort—I am talking about minority and majority—I see no respect for any of us in Government but more than that, deficits that we will never be able to control. In addition, interest rates certainly will not come down.

Mr. Conable will inquire.

Mr. CONABLE. Thank you, Mr. Chairman.

Mr. Secretary, last year the administration took some modest steps to try to refurbish the revenue base in TEFRA. Twenty billion dollars additional would be raised this year if withholding had gone in place. It has not yet. Ninety-eight billion would be raised over a 3-year period. That was a tough step. It was postulated on a $60-billion reduction in expenditures for this year, and presumably for roughly three times that amount over a 3-year period.

Can you tell me to what extent the Congress has delivered on the reduction in expenditures which was part of that assumed deal last year on the raising of taxes?

Secretary REGAN. Well, various people might differ on how you count what is spending cut and what is not, and the like. The estimate that OMB has made for us is that we got 53 cents on the dollar. We had, we thought, a general agreement that there would be approximately $3 of spending cuts for $1 of revenue increase, and it came out about 53 cents of spending cuts for each $1 of revenue raised, and even that ratio will be lowered now unless withholding is maintained.

Mr. CONABLE. So, in fact, we did not make anywhere near the progress on deficit reductions through expenditure control that was anticipated at the time we entered into this implied contract to reduce the tax cut of the previous year.

Secretary REGAN. That is correct, Mr. Conable.

Mr. CONABLE. Thank you very much.

Chairman ROSTENKOWSKI. Mr. Secretary, I am quite proud of the efforts that have been displayed by this committee even though we have had our differences. I am talking about the administration and members of this committee. But I would like for the record at least to show the public that the Ways and Means Committee does its job.

Mr. Secretary, actions already taken by the Committee on Ways and Means during the last 3 years will reduce outlays by $18.8 billion in fiscal year 1984; $22.5 billion in fiscal year 1985; $23.6 billion in fiscal year 1986. I might add that most of these reductions come in the most sensitive programs.

You and I know that there is not much more to cut as far as we are concerned. I just think that if we are to attack the deficits that we all clearly recognize, we had better become quite serious about starting some dialog and discussing ways to rebuild the revenue base. There is no appetite on either side of the aisle, to enact further spending cuts in social programs.

Secretary REGAN. May I interrupt to say, I am not pointing the finger at Ways and Means. The Ways and Means Committee here and the Finance Committee in the Senate were the only ones that kept their part of the bargain on the spending cuts. Particularly courageous actions were taken in a joint effort to salvage that program.

No. Far from it, Mr. Chairman. We are more than willing to work with you. My mention of the 53 cents was in reference to Mr. Conable's question about the Congress as a whole, and not this specific committee.

Chairman ROSTENKOWSKI. Mr. Gibbons will inquire.

Mr. GIBBONS. Mr. Secretary, earlier this year you proposed a contingent tax increase. Is the administration still interested in that program?

Secretary REGAN. Yes, Mr. Gibbons, we are.

Mr. GIBBONS. Are you willing to push it, or are you just kind of expecting us to pick up the ball?

Secretary REGAN. No, we are very serious about this, Mr. Gibbons. But we did have the if. The President said in his message to the Congress, the state of the Union message, and later in the

budget message to the Congress, that if there are spending cuts, he is more than willing to come along with these contingency tax increases.

What we are trying to avoid is raising taxes to par for further spending increases.

Mr. GIBBONS. Well, I want to state my position. I think the cap is mainly a symbolic gesture that is bound to fail and get no place, and add to further disillusionment about the ability of our Government to govern effectively. So, I am not going to participate in what I think is a futile gesture.

But I would be happy to sit down with the administration and with others, work out a reasonable ceiling on spending, and any tax increases, some time in the future. Like you, I do not subscribe to increasing taxes at the present time, while the economy is still in a rather shaky and precarious position as far as recovery is concerned. But I do recognize that in the out years, if we are going to create the confidence that we must have to make this economy operate, we are going to have to reduce the deficit.

I think we have probably taken most of the money out of the social programs that we can now take out. We are going to have to now look at some of the other programs, and it is going to require a dialog for us to sit down and work it out, but I wanted you to know where I came from, and I am interested in your contingency tax program. I do not object to the $5 a barrel oil tax. I think it would be a wise tax to levy out in the future. Some graduated tax of that sort.

I would worry about the surtax, though, because I think, Mr. Secretary, we have got an awful lot of disbelievers out there about the effectiveness and the fairness of our tax program, and I do not want to put additional tax on people who are already paying tax, particularly while there is the apparent unfairness that we have in the system, and I am talking about everything from tax-exempt obligations and extremely accelerated depreciation so that some people are able to manipulate the laws while they have pretty good cash flows, and pay no taxes.

So, those are my views, and I would be happy to work with you and anyone you designate.

Secretary REGAN. Thank you, Mr. Gibbons.

I might add there that one of the things business organizations have been talking to us about is a surcharge on business as being unfair, that those who pay the most would pay even more. Those who are paying the least would not pay as much under a surcharge.

Mr. GIBBONS. That is what worries me.

Secretary REGAN. So we are taking a look at that.

Mr. GIBBONS. We need to look at that. Yes, sir. Thank you.

Chairman ROSTENKOWSKI. Mr. Pickle will inquire.

Mr. PICKLE. Thank you, Mr. Chairman.

Mr. Secretary, first, a matter of figures, to see if I am correct on this. If we had no cap at all on the tax cut, I figure that the person in the top 5-percent bracket, $50,000 and above, would get approximately 30 percent of the revenue associated with the cut and second, if you did have a $700 cap, that top bracket would get about 15 percent of the revenue. Is that basically correct?

Secretary REGAN. Let me check those figures. I do not have a table in front of me of that nature.

[Pause.]

Secretary REGAN. It is approximately. In other words, the repeal of the entire tax cut would take out $25.7 billion. A cap would take out approximately around $5.3 billion, maybe a little more than that.

Mr. PICKLE. Then I would say, Mr. Secretary, we have to ask ourselves, is it fair that we give 30 percent of the tax cut to those in the top 5-percent bracket? You have to ask yourself, is that fair? And I would submit to you that may not be fair.

Now, let me ask you, with respect to interest and dividend withholding, I am not sure where that little animal is right now. Apparently there is going to be a repeal of it, or at least there is scheduled to be. If there is a repeal of it, would the President veto it?

Secretary REGAN. Mr. Pickle, first of all, in reference to your first point, I must point out to you that under the straight, across-the-board, marginal tax cut, those who pay the most also get the most, because it is a fair 10 percent right across the board. Everybody gets 10 percent, which is, we think, a fair way of doing it.

Now, from the point of view of withholding, I, too, do not know where that is at this particular moment. I know that the House has passed a repeal. The Senate, I understand, probably today, will be taking up some type of modification of that. I am not going to commit on anything as far as the President is concerned. He has asked us never to commit him directly.

Mr. PICKLE. Mr. Secretary, if you had a repeal of withholding, or some modification of it, that is going to mean we are going to lose some $2 billion to $3 billion in revenue, each year. Now, where are we going to make up that loss? We have $2 billion or $3 billion additional revenue we have to raise. Do you have a recommendation for that?

Secretary REGAN. No, I do not, Mr. Pickle. I would rather——

Mr. PICKLE. I hear there is some talk about your having a consumption tax. Are you recommending that?

Secretary REGAN. Absolutely not. I know of no consumption tax.

Mr. PICKLE. I keep hearing it in the press, and I keep reading about it, and I thought maybe you were prepared to recommend something like that if the repeal is consummated.

Secretary REGAN. Absolutely not.

Mr. PICKLE. We are all worried about the deficit. Just as a matter of facts, now, just facts, what was the deficit since you have been Secretary, for the years 1981, 1982, and 1983, to the present? Could you give us those figures?

Secretary REGAN. It has to be somewhere close to $400 billion, just under $400 billion. I just did some quick mental arithmetic. I will get the exact figures.

Mr. PICKLE. Somewhere underneath the Moon, is it not?

Secretary REGAN. I would say—you are trying to say these are my deficits, but remember, I did not pass this budget. So I do not accept that.

Mr. PICKLE. Mr. Secretary, I do not intend to say that these are your deficits, but they are the administration's deficits, and if they were the other direction, you would be bragging about them.

Secretary REGAN. I think the Congress has to share here also as to whose deficits they are.

Mr. PICKLE. One last thing, as a matter of policy. Some of us, both sides of the aisle here, recommended a series of tax reforms rather than a broad tax cut, for instance, cutting out some of our losses associated with leasing by nontaxable entities.

Are you in a position to say on behalf of the administration that you would support cutting out these loopholes?

Secretary REGAN. Yes, Mr. Pickle. We do support them. We support your bill.

Mr. PICKLE. I thank you.

Mr. Chairman, we are off to an awfully good start. I wish I had more time. We will come back.

Chairman ROSTENKOWSKI. Mr. Duncan will inquire.

Mr. DUNCAN. Thank you, Mr. Chairman.

Mr. Secretary, I have been on this committee for over 13 years, and I think this occasion is one of the low marks in Congress and indirectly the committee. I say this because I do not think the American people are going to accept very lightly the fact that we are spending millions and millions of dollars to go through a futile exercise, knowing that this so-called tax cap will not become law. We are spending a considerable amount of money on hearings, and on reporters, and it is something that I so far have not understood. We do know that it does come from the Democratic Caucus, and the people I represent, I know, certainly will not approve such action by the majority party.

My question is, How long will it take to implement such a revision if the tax cap is enacted into law?

Secretary REGAN. Hold it 1 minute, Mr. Duncan.

[Pause.]

Secretary REGAN. About a couple of months, 6 to 8 weeks at a minimum, and probably more like 2 months to 10 weeks.

Mr. DUNCAN. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Rangel will inquire.

Mr. RANGEL. Thank you, Mr. Secretary.

I read your statement, and I am so pleased at the sensitivity that you have demonstrated to the middle class that, as you put it, have $197 and $83 lopped off. One of your examples shows the tax cut pared back by $108. There was no sensitivity at all displayed for the rich and the wealthy. I assume if we could adjust this recovery of lost revenues to take care of the people that you specifically mentioned in your testimony, that you would not object to a cap, as long as we were more equitable with those people that you mentioned.

Secretary REGAN. Well, if you want to talk about the other brackets, which you have got to remember is—right now one of the big things we need is to pay for our debts, our deficits. We have to raise funds for that. We need savings in the United States in order to do that. We need savings in the United States in order to have

the capital available for small business, for medium-size business, and for big business to raise additional funds.

If you continually tax it away, you are not going to have that savings pool, and from those upper brackets comes most of the savings in the United States.

Mr. RANGEL. I have not heard anything in your testimony concerning the deficit or balancing the budget. Is that still a part of the administration's program?

Secretary REGAN. You did not hear me say anything about balancing the budget because I do not think that balancing the budget—the way the congressional budget has come out so far as passed by the House and the like does not call for any balancing of the budget.

Mr. RANGEL. So that is out now?

Secretary REGAN. Apparently. We would like to work with the Congress to see if you could work with us to get that.

Mr. RANGEL. Well, my point was that with those amounts that the middle-income people would have lost, have you an idea the impact it has for the family on AFDC who have lost similar amounts under this administration's proposals. For the first time the dollars and cents that I have been talking about now become very important in your testimony as it relates to the two working people in one family.

In other words, you seem quite concerned about what we would take from them, and yet we did not find that same sensitivity when we were taking it away from low-income people.

Secretary REGAN. I am not sure we took anything away from the lower income people. Twenty-five percent across-the-board tax cut. They got their tax cut the same as everybody else did, and will.

Mr. RANGEL. Well, when we passed the 1981 tax bill, was not the administration opposed to any increases in taxes for the next year?

Secretary REGAN. When we passed the 1981? Initially we were, but remember, we worked with the Congress on the 1982 tax increase.

Mr. RANGEL. What caused the administration to change its mind about raising taxes, some $98 billion the very next year?

Secretary REGAN. The size of the deficits, plus the fact that we thought that that was the proper way in our understanding with the Congress that we would get budget cuts at the same time.

Mr. RANGEL. Would you have any objections if the Congress moved in that same direction in terms of closing up loopholes in order to raise taxes to address the deficits that you're talking about?

Secretary REGAN. It depends upon what loopholes and exactly what you are talking about and when. Remember that my point was in answer to previous questions, raising taxes in 1983 as we come out of a recession could be counterproductive.

Mr. RANGEL. Well, if we do not have the revenues from withholding that we and the President expected, would you be prepared to suggest ways that we could make up for that loss in revenue?

Secretary REGAN. No.

Mr. RANGEL. And you told Mr. Pickle that the contingency plan will not be dealing with across-the-board taxes or consumption taxes, is that so?

Secretary REGAN. No. I did not tell him that. He asked if separately we were thinking of a consumption tax to replace withholding, and I said no, we were not thinking of that.

Mr. RANGEL. Does the contingency include any type of consumption tax at all?

Secretary REGAN. No, it does not. Well, to the extent that the oil tax is a consumption tax, yes.

Mr. RANGEL. But you do not have any across-the-board sin-type taxes?

Secretary REGAN. No.

Mr. RANGEL. Thank you.

Chairman ROSTENKOWSKI. Mr. Jenkins will inquire.

Mr. JENKINS. Thank you, Mr. Chairman.

Mr. Secretary, I appreciate your testimony. I think there is a great deal of rhetoric on all sides now about the deficit and so forth. I know that you have indicated that the House-passed budget is a major problem as far as spending.

I was looking in the budget for fiscal 1984. Regarding this $242 billion for outlays in social security, the administration is not advocating any reduction in those outlays for social security benefits, are they, or have I misunderstood?

Secretary REGAN. No. That is part of the social security agreement that was enacted just recently.

Mr. JENKINS. I notice that there is $25 billion for VA service-connected disability checks. The administration is not advocating——

Secretary REGAN. If we are going to go through the budget, remember, I am not that much of an authority on the budget. I would be more than willing to bone up on the budget and go through it with you—

Mr. JENKINS. I am just going to ask about five items.

Secretary REGAN. If you want to talk on the revenue side, I am prepared to do that, but I am not prepared to talk about the actual budget, line item by line item.

Mr. JENKINS. You are not aware of any requests for reductions in the $25 billion for service-connected disability benefits for veterans, are you?

Secretary REGAN. I cannot answer that. I do not know.

Mr. JENKINS. Well, unemployment compensation——

Secretary REGAN. Again, I told you, Mr. Jenkins, I am not prepared to talk about the budget today. I would be more than willing to do that and come back and testify on the budget if you so desire.

Mr. JENKINS. Well, of course, I was under the impression that spending problems are connected with the deficit, and that is why I want to talk about the spending side, I tend to agree that spending is contributing to the deficit.

But as I look at these five items—social security, $242 billion; defense, $242 billion; interest, $96 billion; veterans' benefits, $25 billion; unemployment compensation, $25 million—just taking those five items equals the total revenue that the administration is proposing for fiscal 1984.

So my point is that if we do not make any recommendation for reduction in those five items and eliminate all the rest of the government totally, every expenditure, you still would not have a balanced budget, would you?

Secretary REGAN. You have to admit, Mr. Jenkins, we did not propose a balanced budget this year. We said that in a year in which you are coming out of a recession or in a recession that you can afford to run deficits. We have taken that as granted. We did not try to balance the budget since we were in a recession.

As a result of the stimulation, fiscal stimulation, plus monetary policy, we have come out of this recession. Now, we think that rather than jeopardize the recovery at this time we should not, at this point, try to balance the budget either. We are willing to go along with deficits in 1984, but in the out years we are saying we should then start to bring them down.

Mr. JENKINS. Well, I want to make sure that there was not the impression left that the reason there is no balanced budget in fiscal 1984 is because of the spending measures passed by the House, as I understood you to say. That is not correct, is it?

Secretary REGAN. No. What I said was that the House budget, as passed, calls for a lot of spending increases and taxes to pay for them. And I am saying that we should not raise taxes for that reason.

Mr. JENKINS. I understand that. Do you think if there was a serious proposal to freeze spending across the board at 1983 levels that the administration would seriously support that? That includes defense and every domestic program.

Secretary REGAN. I think that what you would find there is that you cannot do that by law because of the COLA's and things of that nature. There would be no way that you could get an across-the-board freeze. There are also built in through budget authority many defense expenditures that would be increasing this year, so you could not get it in defense either.

Mr. JENKINS. So the administration, for whatever reasons, would not support a freeze of the 1983 levels.

Secretary REGAN. No, we would not support a freeze, but we would support some cuts, selective cuts.

Mr. JENKINS. Assuming that the deficit in fiscal 1984 is $210 billion——

Secretary REGAN. In 1984?

Mr. JENKINS. Yes.

Secretary REGAN. No, we would not assume that.

Mr. JENKINS. What would you assume?

Secretary REGAN. We are assuming, under our current economic forecast and under the President's proposals, about $190 billion.

Mr. JENKINS. And for fiscal 1983?

Secretary REGAN. $210 billion.

Mr. JENKINS. That is $400 billion in fiscal 1983 and fiscal 1984. Assuming that these figures are correct and that the spending as forecast for fiscal 1983 and 1984 is somewhat in line also, what do you see the interest rates being in calendar year 1985?

Secretary REGAN. In 1985? I have no way of telling. Our long-range economic projection is that they would be somewhere in the 8 to 10 percent range.

Chairman ROSTENKOWSKI. Mr. Shannon will inquire.

Mr. SHANNON. Thank you, Mr. Chairman.

Mr. Secretary, I conclude from your testimony that the administration is completely opposed to any cap on the third year of the

tax cut, and that the part that the administration finds most obnoxious is the part that would affect people who earn under $50,000. Is that correct?

Secretary REGAN. Well, we are pointing out the inconsistency in this; that it is a program that has been advertised, at least in the press, as being to cap it for rich people. We are trying to point out this is far from that target. It is missing it completely. The rich are capped, yes, but there are also a lot of side effects of this, maybe unintended, but nevertheless very compelling reasons not to pass this piece of legislation.

Mr. SHANNON. Well, the administration has some revenue proposals which you indicate it still stands behind and intends to push and hopes to get enactment of in this Congress.

I conclude from your concern about those who earn under $50,000 that your energy tax certainly will not affect people who earn under $50,000.

Secretary REGAN. Yes, it would.

Mr. SHANNON. Well, certainly not under $40,000.

Secretary REGAN. Oh, yes. It affects everybody. You know that as well as I do. It is 12 cents a gallon at the pump.

Mr. SHANNON. At what level of income would it kick in?

Secretary REGAN. Anybody that buys gasoline.

Mr. SHANNON. Do you have a chart that would indicate to us the distribution of your energy tax for taxpayers under $50,000 and taxpayers over $50,000?

Secretary REGAN. No, because you would have to figure out what energy usage is of gasoline, diesel oil or heating oil or what have you.

Mr. SHANNON. Well, that can be done, can it not?

Secretary REGAN. It can. It is a lot of work, but we can furnish it for the record if you so desire.

Mr. SHANNON. Would you do that, because I think it would be helpful in looking at——

[The following was subsequently received:]

The portion of the Administration's proposed contingency tax that is accounted for by the $5 oil tax's impact on home heating oil and on gasoline used by households, along with the 5 percent surcharge on individual income taxes is distributed among taxpayers such that 22 percent will be paid by those with incomes over $50,000, and 78 percent by those with incomes under $50,000—roughly the same distribution as applies to adjusted gross income, 21 percent of which is received by those with more than $50,000 of income.

Secretary REGAN. We could perhaps go back to the tax that Congress just passed, 5 cents a gallon on gasoline. We could go back and see how that is being affected.

Mr. SHANNON. Knowing your concern about people who earn under $50,000, I think it would be helpful if we could hold up that $700 cap and hold up that energy tax and see how——

Secretary REGAN. The past energy tax that you just passed in the Congress?

Mr. SHANNON. No. The one that you are proposing. The same is true with the 5-percent surtax. At what income level would that kick in?

Secretary REGAN. That would kick in for everybody.

Mr. SHANNON. So every taxpayer would have his taxes increased by virtue of your surtax. Every taxpayer would have his taxes increased by virtue of your energy tax. And yet you find it difficult, particularly difficult that some taxpayers who earn under $50,000 might have their taxes increased by the $700 cap.

Now, of all the revenues raised by the $700 cap, what percentage of those revenues come from people who earn under $50,000?

[Pause.]

Secretary REGAN. It is about 12 percent.

Mr. SHANNON. Twelve percent would rest on the people who earn under $50,000 and 88 percent would rest on people who earn over $50,000?

Secretary REGAN. That is correct.

Mr. SHANNON. What would the average——

Secretary REGAN. Incidentally, when I asked you on your first supposition about our caring about the difference in taxes and explain why we think a surcharge in 1985 differs quite a bit——

Mr. SHANNON. We have a limited time here.

Secretary REGAN. I also have a limited time, and I think I am entitled to reply to what you have said. You made a charge here, and I want to explain it.

Mr. SHANNON. You certainly are entitled to.

Secretary REGAN. Mr. Chairman, may I answer him?

Mr. SHANNON. You are certainly entitled to reply to the question asked you, and you answered that question.

Secretary REGAN. No, I have not. I have not answered that.

Mr. Chairman, he made a statement here putting words in my mouth, and I would like to explain it.

Mr. SHANNON. I think the chairman might be willing to give us an extra minute. Go ahead. Go ahead, Mr. Secretary. Answer the question.

Secretary REGAN. What I am saying is that the surcharge does affect all tax brackets, but this comes 2 years after the recovery. What we are saying today is that now is not the time to raise taxes, just as we come out of a recession.

Mr. SHANNON. What you are saying, it seems to me, is protect your tax cut now and raise everybody's taxes later.

Secretary REGAN. Unless spending is cut, yes.

Mr. SHANNON. What would the average tax increase, if we were to cap the tax cut at $700, what would the average tax increase for those who have to pay more taxes under the $50,000 range be?

Secretary REGAN. In the $150,000 range?

Mr. SHANNON. No. The $50,000 range. Those who taxes were increased under $50,000, what would the average increase be if we capped it at $700?

Secretary REGAN. It is somewhere in the neighborhood of somewhere between $160 and $700, depending upon——

Mr. SHANNON. The average would be about $161, according to the Joint Committee on Taxation.

Secretary REGAN. That is from $30,000 to $50,000.

Mr. SHANNON. That is right. And for people who are over $50,000, what would the average tax increase be?

Secretary REGAN. $723 in the $50,000 to $100,000 bracket.

Mr. SHANNON. It would be a little over $1,000 average for people who earn over $50,000.

Secretary REGAN. That is correct arithmetic.

Mr. SHANNON. The average tax increase for the smallest percentage of taxpayers under $50,000 affected would be $160.

Secretary REGAN. Yes. But remember, to them $160 is a lot of money. You ask them if they would like to have the $160 or whether they would like to have the Congress tax it away from them. You go out and ask that policeman whose example I gave whether he would like to have a couple of hundred bucks. He will tell you he would like to have it.

Mr. SHANNON. I would have to say, Mr. Secretary, given a choice between giving him a $160 dollar tax increase or giving everybody a tax increase with the administration's energy tax and surtax, I am going to choose the cap.

Secretary REGAN. No. That is apples and oranges. You are not talking about the same thing.

Mr. SHANNON. Why, because the cap is a small tax increase and your tax proposal is a big tax?

Secretary REGAN. No. Our tax increase comes in the outyears after the recovery has taken place, and it is in order to pay for what the Congress and the administration is spending. What I am saying is that now all you are trying to do is to raise to get additional spending in, and that is not fair.

Mr. SHANNON. What you are saying is that you are for fairness now and inequity later.

Secretary REGAN. Absolutely not. That is a mischaracterization.

Chairman ROSTENKOWSKI. Mr. Crane will inquire.

Mr. CRANE. Thank you, Mr. Chairman.

Mr. Secretary, you just made a statement that I got a little unsettled about. You made reference to the moneys that Congress and the administration are spending. The administration does not spend anything. Only Congress spends our tax dollars. You can propose, but we dispose.

Mr. Secretary, let me give you a hypothetical situation. I would like to have your analysis. From an economic impact statement which is better, having a $500 billion budget that is $200 billion in the red, or having a $1 trillion budget that is balanced?

Secretary REGAN. I think of the two I would prefer the first, the one with a deficit but a smaller Federal Government.

Mr. CRANE. Now, is the problem not in fact the magnitude of the bite of our national economic pie being made regardless of whether that comes through taxes or borrowing?

Secretary REGAN. Yes. What we are saying is that there has been a constant increase, decade by decade, in the amount of gross national product that is being spent by the Federal Government. We are up now over 25 percent. In the 1970's and in the 1960's we were down in the 20 to 21 percent range. In the 1960's we were just below that.

Mr. CRANE. If you were to take all of this money through taxation, obviously that must come exclusively out of the pockets of Americans to get a balanced budget. When some of that total expenditure is funded through borrowing what percentage of that comes from foreign sources?

Secretary REGAN. About 15 percent of our borrowing now is from foreign sources.

Mr. CRANE. And thus that leaves an additional 15 percent of total expenditures in the private sector to go to work hopefully to produce the economic recovery that otherwise would be gone if you taxed it away.

Secretary REGAN. That is correct.

Mr. CRANE. Mr. Secretary, one final question. I realize you may not have these figures readily available, and if you do not, I would appreciate it if you could provide them to the committee. What percentage of our total capital pool comes from people in the $10,000 to $20,000 a year income bracket, what percentage of our capital pool—I am talking about savings—comes from $20,000 to $50,000, and what percentage comes from $50,000 and over. And if you have ball park figures at your disposal——

Secretary REGAN. Let me see if any of my staff have that, Mr. Crane. I do not have it right here in front of me.

[Pause.]

[The following was sequently received:]

In recent years 20 percent of all private savings is done by households in the top income decile, those with incomes above $45,000 who would be affected by a $700 cap.

Secretary REGAN. We do not have it with us. I will have to furnish that for the record, Mr. Crane. But my judgment is, of course, quite obviously that the total savings pool, the majority of that will probably come in the brackets between $30,000 and $100,000 of income is probably where the greatest amount of savings would come.

Mr. CRANE. And thus, if this cap were imposed, it works a little bit at cross purposes of trying to increase the total pool of capital, which would in turn have a positive impact on lowering interest rates.

Secretary REGAN. Yes. There is no telling, of course, how the $6 billion, $5½ to $6 billion that would be raised this way, how it would be handled if left in the hands of—or in the pockets of—the taxpayers. My judgment would be probably 50/50; that is, half would be saved and half would be spent.

Mr. CRANE. Thank you, Mr. Secretary.

I have no further questions, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Pease will inquire.

Mr. PEASE. Thank you, Mr. Chairman.

Mr. Secretary, I would like to return to the charts that you showed us before. You talked about 8 million returns that would be affected by the $700 cap, is that correct?

Secretary REGAN. That is correct.

Mr. PEASE. You said almost half of those would be returns of those earning less than $50,000 a year, is that correct?

Secretary REGAN. That is correct. Actually, it figures out to about 48 percent.

Mr. PEASE. How many returns are filed every year totally?

Secretary REGAN. Roughly 90, 95 million.

Mr. PEASE. Roughly 100 million returns. So if we are talking about 4 million returns that would be affected by the $700 cap of

people who are earning less than $50,000, it means that that is about 4 percent of all the returns filed would be affected by the $700 cap, is that right, people earning less than $50,000?

Secretary REGAN. Of those earning less than $50,000. No, wait a minute. You would have to deduct from your 100 million those who would be affected in order to find out what the percentage of those not affected would be. It is a small amount numerically.

Mr. PEASE. It would be about 4 percent, would it not?

Secretary REGAN. Possibly. Maybe a little bit higher than that.

Mr. PEASE. OK. So you have spent——

Secretary REGAN. It would be twice that, about 8 percent.

Mr. PEASE. No, no. Eight percent would be affected by the $700 cap, period. Those earning less than $50,000 would represent only about 4 percent of the American taxpayers. You have told us——

Secretary REGAN. All right. Go ahead.

Mr. PEASE. So you spent all of your testimony talking about 4 percent of the American taxpayers. You tell us that the Reagan administration is worried about these middle-income taxpayers, and yet, you do not talk at all about the 96 percent of the people who would be affected by this cap.

It seems to me that your own testimony today illustrates very clearly the Reagan administration concern is not for the middle class but for the rich, the same as it has been for the last 2 years.

Why not talk about the effect of the cap on the 96 percent of returns and not on the 4 percent?

Secretary REGAN. Well, we already talked about that, and we urged that on the Congress back in 1981 when we got this across-the-board tax cut.

Now, also you have left out those who are earning above $50,000 who are small businessmen who are going to be affected on this, farmers are going to be affected on this and others who will be affected by this.

Mr. PEASE. The fact remains that you have based your whole testimony——

Secretary REGAN. Not my whole testimony. That was about a third of my testimony. The rest of it I spent on deficits, talking about the contingency tax, talking about indexing and other things in the testimony. So I did not spend my whole testimony on it.

Mr. PEASE. That part of your testimony that relates to the $700 cap talks exclusively about what the effect will be on 4 percent of the American people. I think you ought to talk about what the effect is going to be on the other 96 percent, and the truth is that for most of that 96 percent there will be no effect whatsoever, and the remainder are people earning over $50,000 a year who are well able to afford that small contribution to reducing the Federal deficit.

Secretary REGAN. Whoa, wait a minute. Reducing the Federal deficit? They would, if there are cuts in spending, this would be used that way. But if spending is increased as the House budget calls for, which is some $20 billion increase in spending, it is not going to decrease any deficit.

Mr. PEASE. The House budget resolution calls for a lower deficit than that of the administration; right or wrong?

Secretary REGAN. A tax increase of $30 billion.

Mr. PEASE. Right or wrong, it calls for a lower deficit.

Secretary REGAN. With a $30 billion tax increase, yes.

Mr. PEASE. It does call for lower deficits.

Secretary REGAN. With a tax increase.

Mr. PEASE. What is going to happen in your examples that you show, the schoolteachers and the poor secretary and so on, when your 5-percent surtax kicks in in 1986? This proposal would cost the public schoolteachers, each earning $20,000, $83 less if the cap is put on, $700 cap. You are all worried about that.

But the surcharge that you propose would cost them $400 or $500. Why do you not talk about that?

Secretary REGAN. Well, I had talked about our surcharge.

Mr. PEASE. About the fact that it is going to hurt the middle-income people five times as much as this proposal would?

Secretary REGAN. Any tax increase hurts taxpayers, yes, I agree with you on that. That is why we are trying to keep tax increases down as much as possible, and the best way to do that is through a reduction in spending.

Mr. PEASE. What you are trying to keep down is the tax cap right now which would affect the rich in return for 16 months from now kicking in a tax increase that would fall mostly on middle-income and low-income people. I do not think that is a good trade.

Secretary REGAN. First of all, it is not 16 months. Remember we are saying it should start October 1, 1985, which is a further distance.

Mr. PEASE. I am talking about the surtax.

Secretary REGAN. That is what I am talking about. We are not talking about October of 1984. We are talking about October of 1985.

Mr. PEASE. Even longer. So you are going to hit them a little later.

Secretary REGAN. We will not hit them under the contingency tax if spending has been reduced.

Mr. PEASE. No, no. You stated that if spending has been reduced, then you will put in the contingency tax, and if spending has not been reduced, you will not, is that right?

Secretary REGAN. Yes, but I will come back to the original purpose of why we are doing that. We are trying to reduce deficits. I think you have to agree with me that both of us, as the chairman asked, should be working together to try to get deficits down. Do you agree with that?

Mr. PEASE. I agree with that.

Secretary REGAN. All right. Fine. Then how can you do it except by either raising taxes or cutting spending, and we are suggesting a combination of both starting in 1985.

Mr. PEASE. You are unwilling to reduce the deficit now in a way that affects 96 percent of the rich people; and you are quite willing to do it 2 years from now in a way that will affect 96 percent poor and middle-income people. I do not think the American people understand that and would accept it if they did.

Secretary REGAN. Well, I think what they understand is that we are just coming out of a recession and that we have to keep this recovery going, and if you want to abort the recovery, raising taxes is probably a great way to do it.

Mr. GIBBONS [presiding]. The Chair recognizes Mr. Flippo.

Mr. FLIPPO. Thank you, Mr. Chairman.

Mr. Secretary, I appreciate your testimony. I am also interested in the deficit. I thought I heard you say in your discussion of the contingency tax that the reason you were not offering a plan to deal with the deficit over the next 27 months is that we could handle the deficit. And I am curious to know whether you meant that we could handle the deficit from a financing point of view, can we finance it, or are you suggesting that the growth rate in the economy will be sufficient to handle a large portion of the deficit?

For instance, you and the President and other economists speak of the deficit as having a cyclical portion and a structural portion. I am wondering if you are suggesting that the growth that we are currently experiencing will be sufficient to offset the structural as well as the cyclical deficits?

Secretary REGAN. I do not think that is possible, Mr. Flippo, until probably well into the late 1980's before we would hit that happy state, at least on our economic projections. There are very few people who try to project out to 5 years, and those that do know that it is very inaccurate.

But I do not see that happening. Neither the structural part of the deficit nor the cyclical part of the deficit will be removed entirely prior to 1986.

Mr. FLIPPO. Would you give us any kind of proportions on what part of the deficit is structural and what is related to the economic level?

Secretary REGAN. Well, the common rule of thumb is that for every 1 percent of unemployment above what would be considered normal unemployment there is somewhere around $30 billion to $35 billion of deficit. Under that, with 10 percent unemployment, call the cyclical employment 4 percent for round figures, there is about $140 billion that is cyclical at the current moment, and the remainder would be structural.

Mr. FLIPPO. You are not recommending a plan to deal with the structural deficit, then, over the next 27 months.

Secretary REGAN. No, from a revenue point of view, you are correct. What I have been suggesting, though, is that we can work in the meantime to keep the spending down.

Mr. FLIPPO. Mr. Secretary, over the last 3 months M_1 has been growing at a rate of 13½ percent, and I believe that is far above the target, between 4 and 8 percent, and I wonder if this recent growth rate reflects the administration policy, or do you think that the Fed should reduce the growth rate to bring it back within that target?

Secretary REGAN. Well, what we have asked the Fed to do is to have slow and steady growth in the money supply. We recognize that there have been some, call it static, abnormalities in the money supply due to some of the new financial instruments, money market deposit accounts, Super NOW accounts, and the like. We have said that we think that the money supply may be on the high side, but we will have to watch to see whether seasonal factors in April and May were responsible for that.

If they were—and we will know that sometime in July when we see the end of June figures—fine. If not, then I think that the Fed may have to tighten slightly.

Mr. FLIPPO. Do you think that the President should have reappointed Mr. Volcker as Chairman?

Secretary REGAN. No comment, sir.

Mr. FLIPPO. Thank you, Mr. Chairman.

The next is Mr. Gradison.

Mr. GRADISON. Thank you, Mr. Chairman.

I would like to indicate my full agreement with the statement made at the beginning of this hearing by our chairman and by you, Mr. Gibbons. My impression is that the pressure for change in this third year is not coming from the majority members of this committee, or certainly not the ranking members, but perhaps from your own Democratic caucus which appears to believe that across-the-board cuts are unfair and favor high income taxpayers.

I think the members of this committee know better than that. This 10-percent cut that we are talking about today is not the first across-the-board cut that we have had. The Democratic members of this committee advocated and voted for and offered on the floor a 5-percent across-the-board cut 2 years ago without a cap and a 10-percent across-the-board cut a year ago without a cap. They took the lead in advocating the decline from 70 to 50 percent in the marginal tax rate, which has done more to benefit high income taxpayers than anything we are talking about today. That was not in the administration's proposal. It was added by a Democratic member of this committee, Bill Brodhead of Michigan, and also it was a Democrat, Jim Jones of Oklahoma, who took the lead along with others in advocating the drop from 49 percent to 28 percent in the maximum capital gains tax rate.

Now, there was no proposal then to cap the capital-gains tax rate or to cap the 5-percent cut or to cap the first 10-percent cut. These questions of fairness have arisen only 2 weeks before the third of this series of across-the-board cuts are supposed to take effect. And the recommendations are being made without any reference to the fact that the upper half of all American families that pay income tax pays 94 percent of all the individual income tax, and the upper 10 percent pays over half; this is hardly a situation where upper income people are getting a free ride.

But I would like to indicate, Mr. Chairman, that if you do bring this to markup—and I assume that is your intention—you would not do it unless you have the votes to enact this cap. Then it would be my intention at that point to put to the test the objective of the members of this committee on the other side of the aisle by offering, along with the cap, an amendment to accelerate indexing. The amendment would be proposed in such a way that the savings to the Government which would be realized by putting this cap into effect would be plowed back into an acceleration of the indexing which would take effect on March 1 of next year. It is a slight gain to the Treasury but it is intended essentially to be revenue neutral.

I think that may be a way of finding out how much of what we are discussing here is rhetoric and how much is a sincere effort to help the middle- and low-income groups. I assume it is the latter, and I think that will be a good way for all of us to demonstrate our

support for that cause at markup. I thought it might be useful to use the limited time available, rather than asking questions, to just indicate this member's thinking on that subject.

And I thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Anthony will inquire.

Mr. ANTHONY. Thank you, Mr. Chairman.

I would like to expound on some things that my colleague from Ohio has pointed out concerning the Democratic proposals on the reduction of the marginal tax rate and on the capital gains tax rate. There was also another Democratic proposal on increasing gift and inheritance taxes that the administration had rejected during the bidding war in 1981. Its purpose was to try and give some relief to those people who had their properties escalate in value due to inflation.

And knowing now that there are three very good proposals that came as a result of the Democrats, would you please go back to the White House and ask our President to quit holding press conferences and saying that the Democrats are the party of tax, tax, tax, and spend, spend, spend. In fact, there are many Democrats who have been successful in proposing tax reductions, and have advocated some additional changes under our tax code to make it more equitable.

As the chairman of the committee pointed out earlier, we are getting into the high season of political rhetoric, and I would hope that our President would not deceive the public and would let the people know that the Democrats are for fair and equitable tax revenue and spending policies although we have a difference of opinion on how to get there.

I would accept your challenge and let you come to my district and talk with the police officer and the nurse, who each make $23,260 annually, and ask them if they want the Treasury to continue borrowing and go into debt in order to pay them $197 jointly. I offer you the invitation today to come to my district and talk with the secretary and the chemical engineer, but more particularly, talk with the schoolteacher who is going to get $83 from the Treasury. And I will tell you what they told me when I ran for reelection in 1982. It makes no sense to borrow from the Treasury in order to give the police officer, schoolteacher, et cetera, a tax break if the interest rates are going to escalate at the end of the year. This would force that police officer or schoolteacher to pay the tax relief to their banker if they made a loan for a new car, or made a loan to educate their children.

I have just done some quick calculations and I know what your response is going to be. However, my constituents are going to say they do not care what you have done for them in the past but want to know what you are going to do for them in the future. I know interest rates have come down. But if my police officer and nurse jointly go to the bank and borrow $10,000 for whatever emergency they may have, and you can get interest rates to come from 12 percent to 10 percent, then they have more than offset the cap that we would propose of that $197.

So I basically have two questions for you, Mr. Secretary.

What level of interest will this administration tolerate? And when does a $200 billion deficit give you a sharp pain?

Secretary REGAN. Well, first of all, we are committed to trying to get interest rates down as fast and as quickly as we can.

As you know, Mr. Anthony, an awful lot of what is built into the high rates of interest now are worries about our deficits and what we are going to do about them and how we are going to handle them in the future, whether we are going to monetize them or indeed whether we are going to pay for them.

Our suggestion is that we pay for them in the form of reduced spending coupled with tax increases in 1985.

Now, as far as getting those down, under our suggestions, they come down—even with our April estimates—from $210 billion in 1983 to $190 billion in 1984, and on down to the $100 billion level in 1988. We think that is achievable if we—that is, you, I, the Congress, and the administration—work together on this. We think that it gives us a pain right now to have a $200 billion, very frankly. But we will work as quickly as we can get that down.

Mr. ANTHONY. I like the manner in which Mr. Gibbons summarized the situation. He knows that this is a lot of political hype, and that the President holds the trump card with a veto, and the votes are not there to override the veto. So to some extent we are going through a lot of political posturing which is not going to offset the fact that we still have some real problems on the revenue side.

When the chairman says that we are going to have to give a critical and credible response to that, I do not think we can delay it until 1986 because the revenue problem is too great. And if it weren't for the political side entering into this, I think we could arrive at a better solution, economically. Unfortunately, politics may get wrapped into all of this as it did in 1981. Nevertheless, I am willing to work with you on the revenue to try and make our tax code more fair and equitable to all taxpayers.

Secretary REGAN. Thank you, Mr. Anthony.

Chairman ROSTENKOWSKI. Mr. Dorgan will inquire.

Mr. DORGAN. Thank you, Mr. Chairman.

Mr. Secretary, when you discuss these general economic issues, the record does not match the rhetoric. You talk about spending and holding spending down. Let me give you a couple of numbers.

The administration in 1981 came to us with a program, and you suggested revenues and spending targets for the outyears. You said then that in fiscal year 1984 you expected a budget of $770 billion in revenue and $770 billion in spending; 1984 came along, you submitted a budget that called for not $770 billion in spending, but $850 billion in spending; not $770 billion in revenue, but $660 billion in revenue; $110 billion less in revenue than you had expected 2 years earlier.

You then said it is acceptable for this administration to ask for a Federal budget deficit approaching $200 billion. That is the budget you sent us.

If you have experienced a $110 billion decrease in expected revenue, do you not think you ought to do something about it, and if you think so, what are you doing about it?

Secretary REGAN. Well, you first of all have to ask why did we have the shortfall in revenue, and the answer is the recession. That

recession was not forecasted by us nor by any other economist I know of when we submitted our budget in January of 1981.

As we disscussed in answer to a previous question about the cyclical part of the deficit, you have to admit there is a cyclical part to it, and a great deal of that $110 billion is due to the unemployment situation, lack of earnings on the part of corporations, lack of earnings on the part of individuals. That is why we are not collecting that tax revenue.

Mr. DORGAN. I understand the reasons for it. The question is, should we do something about it, and if you think so, what are you doing about it?

Secretary REGAN. Well, I do not think that you want to raise taxes in a recession. I do not think you want to raise taxes just as you come out of a recession.

Mr. DORGAN. Do you think you ought to decrease taxes at a time when you have a $200 billion Federal deficit?

Secretary REGAN. Yes.

Mr. DORGAN. You do?

Secretary REGAN. Yes; I think that is stimulative to the economy and that will enable us to get our revenues coming back.

Mr. DORGAN. Are you a Keynesian? This is the third time today you have used "stimulative," "fiscal stimulus."

Secretary REGAN. I am a pragmatist. I have been a financier for 35 years. I think I know how to handle these things, and if you can show me any theory that says that raising taxes at this particular time will succeed in helping this recovery, I would like to see it. I have never seen any such evidence.

Mr. DORGAN. Well, if you think you are handling things with a $400 billion deficit this year and next, I guess your definition of handling them is different than mine and the folks I represent.

Secretary REGAN. Mr. Dorgan, I hate to remind you, but as was pointed out here, the Congress is the one that passed this budget, not the administration.

Mr. DORGAN. I see. Well, so the Congress then is going to——

Secretary REGAN. Well, let's not talk about just us handling it that way. Let's say we together.

Mr. DORGAN. Sure. I was talking about the budget that you folks have submitted this year calling for $660 billion in revenue, $850 billion in spending, and $190 billion in deficits, coupled with next year's anticipated deficit of close to $200 billion—$400 billion in Federal deficits in 2 years—and a suggestion that at that time we should continue the third year of the tax cut which will be the largest single yearly tax cut in our history, as I understand it.

Let me try and take it from a macroeconomic standpoint down to specifics. Someone making $200,000 a year under the third year of the tax cut will receive a $4,300 benefit from the third year of the cut. A family of four, $20,000 a year, $165.

Should we borrow money—should the Federal Government borrow money to give a $200,000-a-year person a $4,300 tax cut, in your opinion?

Secretary REGAN. Well, wait a minute now. What you are suggesting is that all of that person's money belongs to you and you are going to suggest how much you are going to let him have?

Is that what you are saying?

Mr. DORGAN. No; I am suggesting that the Federal deficit is out of control.

Secretary REGAN. I do not follow it. I think right at the present time borrowing is superior to taxing, yes, because I think that for the Federal Government to be spending this money is wrong. I think individuals spend money a lot better, and if you were to tax, I think you take away individuals' incentives. If you do away with this third year tax cut, you raise $30 billion. Will that cut Government spending? No. That is not going to cut spending.

And you know darned well what is going to happen then. People are not going to have the same incentive to save or to work.

Mr. DORGAN. Well, in the finest sense of the word, using the term "politics," we are going to establish through the political system what we do in fiscal policy in this country. And I find the whole exercise disingenuous on the part of the administration. Six months ago the administration was holding hands on the steps of the Capitol, wanting to place in the Constitution a prohibition against what you are suggesting we ought to do now—rack up $400 billion in deficits in 2 years.

The whole thing smacks of the worst kind of politics that does not do any good for the country's future economic course. I would hope that we can, as Congressman Anthony said, start cementing some cooperation between the administration and this committee and Congress and stop the fingerpointing.

But I have not been supportive of the tax program that you have given to this Congress. A friend of mine uses a line from Bob Wills and the Texas Playboys, that old country group, and it always reminds me of your tax program. It says the little bee sucks the blossom, the big bee gets the honey. The little guy picks the cotton, and the big guy gets the money.

I think that pretty well describes the problems of the 3-year tax program that you have given us. I think it is precisely why folks are now trying to analyze how we can reduce the deficit and avoid the burgeoning interest rates that will come if we have a $400 billion Federal deficit in this 2-year period.

Chairman ROSTENKOWSKI. Mr. Moore will inquire.

Mr. MOORE. Thank you.

Mr. Secretary, something I think has gone unnoticed so far in this discussion today is the fact that a lot of people have the idea that this $700 tax cap is just that. It is simply, you get up to $700, you do not get any more in terms of a reduction in your taxes in July of 1983.

It is my understanding from reading this proposal that that is not what it is at all. It is actually a changing of the tax rates so that you do not get back over $700, not simply a capping on the amount of return you would get.

Am I correct in that?

Secretary REGAN. You are absolutely correct in that. That is what I was trying to show with this chart, that the tax law will have to change to indicate new bracket rates, permanent bracket rates, with a much faster step up and a steeper step than under current law.

Mr. MOORE. And something else I think has gone unnoticed. Most people, I feel, have gotten the idea that the $700 tax cap is

just a one-time, 1-year loss of that tax reduction. But from my reading of it, this is a permanent change in the tax rates, meaning that these people will actually be limited to $700, not just this year, but forever. We are actually raising their taxes again.

Am I right in that?

Secretary REGAN. That is right because the brackets will be stepped up and, in addition, a lot more people will be brought into this as inflation-bracket creep brings them into these new brackets much more rapidly than under the current law.

Mr. MOORE. So, then, we are really not just talking now about a 1-year cap on the amount of tax cut that individuals would get. We are talking about a permanent change in the marginal tax rates of the American people—raising their taxes.

Secretary REGAN. That is correct.

Mr. MOORE. Mr. Secretary, as you did testify, this flies right in the face of what we did in 1981 to cut the marginal tax rates of the American people by 25 percent over a 3-year period, which a number of my Democratic colleagues supported in their own version.

Now, it seems to me that this is a reversal of tax policy, not a capping of the amount of money people would get for 1 year.

Mr. Secretary, this being the case, could we expect you to recommend a veto to the President if we passed such a bill with nothing else on it?

Secretary REGAN. I would, and I believe that the President probably would veto it, too.

Mr. MOORE. Mr. Secretary, I would hope he would, and I think that the gentleman from Florida, Mr. Gibbons, is right, and the gentleman from Arkansas, Mr. Anthony, is right, that there are going to be more no votes on the House floor to sustain such a veto. So this in fact is a political exercise.

Mr. Secretary, I think that if we were to consider anything like this, we would have to go back and consider something like what was done last year but did not work out. That is, if my colleagues are really interested in raising taxes to bring down the deficits, we are going to have to see some good faith effort to reduce spending at least. I think we have got real reasons to wonder whether they could do it this year, since they could not live up to a 3-to-1 cut last year. .

Mr. Secretary, I appreciate your testimony.

Secretary REGAN. Thank you.

Chairman ROSTENKOWSKI. Mrs. Kennelly will inquire.

Mrs. KENNELLY. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here.

I was not here when ERTA was passed, so I may have a more open mind on it. I think there is nothing wrong with having this kind of hearing, and I think it does educate people. The press is over there and people find out what we are thinking about.

I am worried about one particular aspect of what you were saying, and that is the contingency tax on oil of $5 per barrel. I come from the State of Connecticut, right next to Mr. Shannon's State. Rough arithmetic, $5 a barrel, 42 gallons in a barrel, that is 12 cents a gallon.

Mr. Shannon asked you for figures about oil and energy, and I think they would be good to have. I think if I took the two teachers that are married in your example and I took the GS–12 worker and what they would get back, I think that rather than have a $5 a barrel tax, they would rather have that little bit taken away by the $700 cap.

But what I want to ask you, sir, is there any thought of having an across-the-board energy tax as a contingency tax rather than just go after people in New England and the Midwest who really rely on oil?

Secretary REGAN. Well, while we have not fleshed out the oil tax, putting it at $5 a barrel would indicate that it would hit all oil products. We did not go the further step and say let's tax all energy. We have not taken that step as yet.

And I might add here that we are perfectly willing to talk about this contingency tax and the makeup of it, provided that we see—in all honesty, and not hear just rhetoric—some of these spending cuts coming along. We are more than willing to talk about the makeup of that contingency tax. These are our suggestions. If there are better ones, we would listen.

Mrs. KENNELLY. Mr. Secretary, am I right that the $5 a barrel tax would be triggered if the economy did not recover down the line?

Secretary REGAN. Let me try to explain this a little more fully. What we said is that there would be a series of conditions. If there were spending cuts, and if the economy were not sufficiently strong to get the total Federal budget to where the deficit was 2.5 percent of gross national product or less, if it is less than that, no tax.

Mrs. KENNELLY. The trigger worries me, too, because something may happen in the Mideast, and then the economy may not improve, and then we have the tax triggered, and as a result we are hit twice.

I would second Mr. Shannon's request, if we could have the figures he asked for. We should continue the dialog, because I think we will be talking about this for a while.

Thank you, sir.

Secretary REGAN. Thank you.

Chairman ROSTENKOWSKI. Mr. Stark will inquire.

Mr. STARK. No questions.

Chairman ROSTENKOWSKI. Mr. Matsui will inquire.

Mr. MATSUI. Thank you, Mr. Chairman.

Mr. Secretary, in your written statement you show four examples of persons who would actually lose money if we place a cap of $700 on the third year of the tax cut. You make an assumption in each of these examples that the individuals do not itemize, and they lose money notwithstanding incomes of $43,000, $40,000, $41,000, and $32,500 respectively.

The problem I have is that if you look at these figures, $43,000, $40,000, $41,000, $32,500, a great majority of these people in these income brackets itemize their deductions. They probably have purchased a home, and they probably deduct anywhere from $500 to $1,000, perhaps, a month on their home deduction, and with that being the case, perhaps you and your staff should give us figures

on what the average individual who itemizes at these income brackets would save or lose with this cap.

I think your figures would be dramatically different. In fact, I think it would show that these people probably do not suffer any appreciable loss if there is a $700 cap.

Could you respond to that?

Secretary REGAN. Yes, I would be more than happy to submit all of these for the record. What I was looking for quickly here is one example I recall, example No. 2. We did show it both ways. And that is a couple with just about $50,000 of joint earnings. The 1984 tax reductions are $1,179 if they did not itemize. This reduction would be cut back $459 by the cap. It would be cut back $134 if they did itemize.

Mr. MATSUI. OK. If you could get us these figures on these others, that would be helpful.

Secretary REGAN. We will submit those for the record.

[The following was subsequently received:]

TAX INCREASE CAUSED BY A $700 CAP

Example number	Without itemized deductions	With itemized deductions
1	$197	
2	459	$134
3	83	
4	108	

Mr. MATSUI. As we will be marking up the bill quite soon, could we have them quickly?

The other question I have is, assuming the Budget Committee completes its process, and the conference recommends a revenue increase of between $9 to $12 billion for the 1984 fiscal year, is it your intent or the administration's intent not to participate in developing a revenue proposal on the basis that you will veto whatever we come up with? Or will you participate by offering us suggestions as to where we might come up with those revenue targets?

Secretary REGAN. I do not think we would be in the position of offering you suggestions as to how to raise revenues. I think obviously we would be willing to work with you from the point of view of technical comment, from the point of view of expert advice the Treasury experts have to give to this committee and the Senate Finance Committee, and we would reserve judgment on the individual items until we saw what you were suggesting.

Mr. MATSUI. But you would not want to give us a list of priorities in the event——

Secretary REGAN. No; we have no intentions this year of coming forward with any new tax revenue measures for fiscal 1984.

Mr. MATSUI. Even if this has bipartisan support in the Congress?

Secretary REGAN. Except for one. There is one that we have already suggested which, as you know, is the limit on deductions by an employer for his employees on medical expenses.

Mr. MATSUI. The last question I have is that in 1981, when Mr. Stockman and you appeared before this committee and gave a scenario concept in terms of projections over the 5-year period, with

the revenue projections in terms of a share of GNP being 19.6 percent. That was based on the fact that with the tax cut, and with the ACRS, we would have an expansion of the work force, more jobs, and that would in turn raise more revenues from the economy for the Treasury.

CBO now says that the 1986 figures, according to their February data, would be 18.5 percent, or 1.1 percent less. Given that you are looking at percentages of GNP in terms of your earlier analysis of 19.6 percent, do you not think that we can afford to increase taxes by 1.1 percent of GNP by 1986, so that we can gain the additional $180 billion of revenues to offset projected deficits? Or would you say that you would rather keep it at 18.5 percent?

Secretary REGAN. No; I think that is what we are suggesting. I think that if you consider in 1986 that on the various projections—of course, gross national product will be plus or minus $4 trillion—we are suggesting tax increases in fiscal 1986 of about $42 billion.

Mr. MATSUI. OK. Well, if you can suggest that, and if you stay consistent with that, then how about 1984? In 1981, in your scenario, you predicted that we would have 19.3 percent of GNP dedicated to revenues to the Federal Treasury. CBO projects for this coming fiscal year 1984 only 18.7 percent or six-tenths of a percent less. Do you not think that we can afford the additional six-tenths of a percent for the 1984 fiscal year, and that would keep it consistent with your original 1981 projections that would have created a half a billion dollar surplus in the budget deficit?

Secretary REGAN. Well, you see, what has occurrd in between, as I explained in my answers to Mr. Dorgan's questions, is the recession.

Mr. MATSUI. Oh, no, I am not——

Secretary REGAN. Economically, at this time, we do not think that it is right, even in fiscal 1984, to be raising taxes, because we think it might jeopardize the strength of the recovery.

Mr. MATSUI. Even $9 or $10 billion?

Secretary REGAN. Six-tenths of 1 percent would be $18 billion.

Mr. MATSUI. But I am talking about the $9 or $10 billion. We are not going to get the $18 billion, obviously.

Secretary REGAN. No; we do not think any tax increase of that size is justified at this point. That is why I am here.

Mr. MATSUI. Thank you.

Chairman ROSTENKOWSKI. Mr. Campbell will inquire.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Mr. Secretary, let me ask you a question. You are forecasting a 4.9 percent real growth in the GNP next year. How would the deficit be changed if that growth turned out to be 6.5 percent?

Secretary REGAN. Six and a half?

Mr. CAMPBELL. Yes.

Secretary REGAN. Let me try to be precise. I would think it is on the order of a $20 to $30 billion reduction next year, but I want to be more precise.

[Pause.]

Secretary REGAN. My economist thinks I should make that more like $15 to $20 billion reduction in the deficit.

Mr. CAMPBELL. OK, but the fact is that if we had this growth, and we continued this economic recovery, we are going to reduce

the deficits more than if we took a chance on raising taxes and aborting the recovery. Is that not correct?

Secretary REGAN. Oh, that is correct, very definitely, Mr. Campbell.

Mr. CAMPBELL. What we are talking about raising here differs by about a 4 to 1 margin, as I look at the figures. So are we not really gambling by trying to raise taxes and risk aborting a recovery which would reduce the deficit by more than the taxes we are raising?

Secretary REGAN. That is exactly what we are saying here, that we would rather see the recovery come in and stay strong and collect taxes that way.

Mr. CAMPBELL. So we are dealing with the mentality of let us just tax it, no matter what happens. If we raise taxes, which is what the proposal does—make no bones about it—then we run a terrible risk of aborting the recovery, which could cost us far more, in terms of the amount of the deficit in the long run. Is that not correct?

Secretary REGAN. I would agree with that; yes.

Mr. CAMPBELL. Turning to the fairness question, did the lower income people at all benefit by the provision which reduced them to a marginal rate from 70 to 50 percent?

Secretary REGAN. Did they benefit?

Mr. CAMPBELL. Yes.

Secretary REGAN. Certainly.

Mr. CAMPBELL. The lower-income people. I am talking about the people who are not at that rate. When we cut the top rate from 70 to 50 percent, who benefited? I supported the reduction and I might add that it was offered by the other side.

Secretary REGAN. Everybody benefits from that.

Mr. CAMPBELL. Everybody benefited from it, but the bulk of the benefits went directly to the upper income. Now, the point I am driving toward is this: When we cut from 70 to 50 percent the top marginal rate, the argument was we would get people out of tax shelters, put their money into productive use, put it into savings, and encourage capital formation; and it has worked.

Now, if we go the other way by capping the third year tax reduction, do we not also encourage people to start again seeking tax shelters and taking their money out of productive use?

Secretary REGAN. Oh, sure. The more you tax, the more people are going to try to avoid taxes. That is only natural.

Mr. CAMPBELL. So, in fact we could be working against the creation of more jobs in this country by doing this?

Secretary REGAN. Well, this is the point I tried to make as far as small business is concerned. As you know, a great many of our jobs, perhaps more than half of them, come from corporations with less than 100 people. That is the very type of people who need as much in the way of tax breaks as they possibly can get, and in my judgment it is counterproductive to try to raise taxes on them.

Mr. CAMPBELL. Well, I think we have pretty well established what we are doing. We could abort a recovery which could cost jobs. And we could encourage people to hide their money in tax shelters rather than to put it into productive capacity if we pursue this course.

Let me go back to the fairness question again. As I look at the marginal tax rates, it shows me that a person who has taxable income in the low thirties is going to have a 9-percent increase in their marginal tax rate if in fact we cap the reduction at $700. Is that a correct statement?

Secretary REGAN. That is correct, a nine-point jump for earning an extra-dollar.

Mr. CAMPBELL. Nine percent increase on a couple or a person having taxable income in the low thirties. I think that is something that people ought to focus on.

Finally, let me throw something out to you. As I look at the growth in domestic spending, and I look at the decline over the past decade in defense spending, it is obvious that the growth in domestic spending has caused a great deal of our troubles. The administration cannot spend anything that we do not appropriate. We are all in this together.

A lot of that is uncontrollable; that is, entitlements. I think that we ought to be looking at a combination of a package in the future dealing with the growth of automatic expenditures and a tax package as we look out to 1985. Would you be amenable to exploring that if we could come up with such a package?

Secretary REGAN. I would be more than happy to discuss it with you if you could come up with such a package, yes.

Mr. CAMPBELL. I have one that raises about $128 billion between 1985 and 1988, and it deals with a 3-percent trigger on indexing and on entitlement programs as an offset. It gets us back in control of the budget. I would love to discuss it with you.

Secretary REGAN. I would be glad to.

Chairman ROSTENKOWSKI. Mr. Guarini will inquire.

Mr. GUARINI. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. I know much has been said about the $700 tax cap as being fair and equitable, and a lot of discussion has taken place here. I have been one of the original supporters of this proposal, because it would exempt 92 percent of our people. As I look at what we have done in the last few years it is apparent that we have taken care of the wealthy. We have brought down the capital gains tax rate from 28 to 20 percent. We have taken down the top marginal rate 70 to 50 percent. IRA's certainly do not help any of the 16 percent of the unemployed in my district, but certainly can help people that are in the middle income and above.

So, that has been something that has happened, but we never really do very much about the underground economy that is supposed to be in excess of $100 billion. We never really have done very much about over 200 billion dollars worth of tax expenditures that go out through our Tax Code, much of them to large corporations. We have not done anything, either, about the capital gains taxes that are uncollected. We do not collect 40 percent, 44 percent of the capital gains taxes owed in our country, according to statistics that I have seen.

So, there must be an awful lot of uncollected taxes out there that, as the Secretary of the Treasury, you might be able to put your hand on. But the larger question is world recovery, and what is necessary for world recovery, because all nations are all in this together. If we do not have a world recovery, no matter what we do

here in our country, our economy will perhaps go down with the rest of the world.

I refer to an article in the Washington Post concerning a report by the Bank of International Settlements. May I just ask you to comment on this after I make a short statement on it? It says:

"The Reagan Administration must reduce sharply its huge budget deficits, which cause high interest rates, or be saddled with the blame for not only an aborted global recovery, but also a continuing third world debt problem" the Bank for International Settlements at Basel said today. In its annual report, the BIS, sometimes called the central bank of central banks, asserted that high U.S. interest rates are damaging, that the responsibility for getting them down clearly falls on the U.S. authorities, and squarely on the shoulders of those in charge of fiscal policy.

Which is ourselves.

Now, they are talking about deficits coming down now, not 4 years from now, because the third world nations need immediate help. In addition the other countries of the world and our global trading partners look to the United States to bring our deficits down today, not waiting for 2 years where we have a $200 billion deficit this year and a $200 billion deficit next year, and then going on to a contingency tax.

So, the question I propose to you is: What is your comment on this from a global viewpoint, where we know that the rest of the nations of the world are looking for our leadership. If we cannot give them that leadership of bringing interest rates down by bringing our deficits down—and not having a $200 billion deficit, which is going to be a fact this year—we are looking for a world tragedy in economics.

Would you comment on that, Mr. Secretary?

Secretary REGAN. Certainly. First of all, we agree with that. We think we should bring our deficits down. That was part of the agreement. And by the way, their wording is practically lifted word for word, syllable for syllable, from the Williamsburg Statement, to which we were signatories. We do agree that deficits should come down. We are rather surprised, though, that being central bankers, they did not mention monetary policy as also being part of this picture here in bringing interest rates down.

But nevertheless, in spite of their omission, we would agree with them. Now, what they went on to say was that this should be done primarily through cutting expenditures, and if not, and as a result of that, and together with that, some tax increases if needed, we would agree with that. That is exactly what we proposed in our contingency plan.

Mr. GUARINI. But when we talked about deficits, the nomenclature on the part of the administration is always domestic deficits, but when we look at the whole package, as to what we have to borrow and go out into the marketplace, we are talking about defense spending as well as domestic spending. So that we are never really talking on one track. We are always on two tracks.

If we are to keep our deficit down, we have to keep it down both ways, domestically and defense spending. But it seems to me that it is always discussions which has just taken place just a few minutes ago about domestic spending, and entitlement programs, and nothing about defense spending, and I think that that is where we are missing our dialog.

Chairman ROSTENKOWSKI. Mr. Thomas will inquire.

Mr. THOMAS. Thank you, Mr. Chairman.

Mr. Secretary, back to the fairness aspect of this so-called $700 cap, which is a misnomer, as we saw in the questioning from the gentleman from Louisiana, in a number of ways. It does not provide $700 this year. It, in fact, is a permanent tax increase. But my question is, Of the 8 million returns, indicated by your pie chart, that would be affected by the so-called $700 cap, do you know offhand what percentage of those are two-earner households?

Secretary REGAN. Just about half. I think it is about 4 of the 8.1 million are two wage earner households.

Mr. THOMAS. So about 50 percent of the people affected by this tax increase would be two wage earner households.

Secretary REGAN. And of the amount of money involved, of the $5.3 billion that we think would be raised by this cap, $2.6 billion, which is exactly half, will come from those households.

Mr. THOMAS. Did we not have a lot of concern generated about a so-called marriage tax, to the point that we had to modify the Tax Code to provide some relief for those people who were unfairly taxed, because they happened to have two incomes, and half of these people will be affected. If you look at the tax rate increase there was a proposed 5-percent increase, and this $700 cap adds an additional 4 percent on top of it, but it is only for one particular group. Is that true?

Secretary REGAN. That is true.

Mr. THOMAS. What tax theory defines fairness as a 9-percent jump for one particular group?

Secretary REGAN. I do not know of any. I think to raise the question is to answer it.

Mr. THOMAS. In terms of the dollar amount, it is in the midthirties where that 9-percent increase takes place.

Secretary REGAN. It is around $35,000 of taxable income.

Mr. THOMAS. Do you have any statistics that show what has happened to that general marginal rate position because of bracket creep over the last decade?

Secretary REGAN. Hold it 1 minute. I will see if I can find any answer to that.

[Pause.]

Secretary REGAN. If you consider someone with taxable income of about $35,000, back in 1975 they had $19,500, so they have crept up, and the bracket at that time would have been 28 percent. Now they are up into the 33-percent bracket. They probably will soon be on up into a much higher bracket from there.

Mr. THOMAS. So where you have a 9-percent jump at that middle $30,000 range, you had a significant number of people moving into that category, a movement which will continue since I understand this change is permanent. And that 9 percent marginal rate jump is built in—is that correct?

Secretary REGAN. That is correct. That is a permanent change in the Tax Code.

Mr. THOMAS. So every year people will experience a 9-percent jump when they reach the $33,000 level. It is my understanding that in 1960, only about 3 percent of the returns were at that 30 to 35 percent marginal tax rate. Today, about a third of the taxpayers

are at that level, and so you have a strange, in my opinion, 9 percent jump, and what I need is a rationale why it was placed at a level where a significant number of people may enter that tremendous jump in the decade of the 1980's. Many of those people are going to be two-earner households, working hard to try to make it, and once they reach what at one time we used to call making it, they get hit with a 9-percent marginal rate increase. I am trying to understand what tax theory defines that as fair.

Secretary REGAN. I cannot answer that question for you.

Mr. THOMAS. Thank you, Mr. Secretary.

Chairman ROSTENKOWSKI. Mr. Russo will inquire.

Mr. RUSSO. Thank you very much, Mr. Chairman.

Mr. Secretary, I want to follow up on some of the comments made by my Republican colleagues, and to follow up on Mr. Shannon. Is it not a fact, and I think you have already stated this, that 88 percent of the revenue that is generated by this $700 cap comes from people over $50,000? Regardless of what they are talking about over here about this being a permanent increase, 88 percent of the revenue generated is from people earning over $50,000? Is that a fact?

Secretary REGAN. Yes, that is correct for the year 1984. Of course, you realize with the permanent change in the Tax Code, that will eventually shift more and more people into those brackets.

Mr. RUSSO. Now, in your statement, Mr. Secretary, you say that the truth is that just about half of the 8 million returns that would be affected by the cap are filed by single individuals and married couples earning less than $50,000. In actual numbers, it is about 45 percent that are affected. But could you breakdown the brackets? Is it $45,000 to $50,000? Is it $40,000 to $45,000? When you say just about half of them, how is that half distributed? Is it $49,000, $48,000, $47,000? I think we need to be a little bit more specific.

Secretary REGAN. I do not have those in my table. My tables go by tens, from adjusted gross, $20,000 to $30,000, $30,000 to $40,000, $40,000 to $50,000.

Mr. RUSSO. For purposes of the committee, it would be very helpful, Mr. Secretary, if we can breakdown exactly where the lower half of that 8 million is, when you say under $50,000.

Secretary REGAN. We will try to get that for you.

[The following was subsequently received:]

Of the 48 percent who are affected by the cap and have incomes below $50,000, 17 percent have incomes between $45,000 and $50,000, 17 percent have incomes between $40,000 and $45,000; and 14 percent have incomes between $18,600 and $40,000.,

Mr. RUSSO. Mr. Secretary, you found it important enough to say in your statement "Some single taxpayers who do not itemize deductions will be affected, even though they earn no more than $30,000 of gross income."

How much of a tax increase is that single individual going to be affected? How much of a tax increase? Do you know what that dollar amount is?

Secretary REGAN. For the single individual in the thirties?

Mr. RUSSO. Yes, $30,000. How much is that individual going to be affected?

[Pause.]

Secretary REGAN. We will find that.

Mr. RUSSO. The comment that I received——

Secretary REGAN. It is $108.

Mr. RUSSO. If I am not mistaken, I talked to one of the members of the Ways and Means Committee staff and they told me it was $4. Those single taxpayers——

Secretary REGAN. This is a single person, $32,500 earnings, not itemizing, 1984 tax cut pared back, $108.

Mr. RUSSO. Well, I have here, it says, "Some single taxpayers who do not itemize, even though they earn no more than $30,000 of gross income." That is what your statement says. And I understand from checking with the Ways and Means staff, that amounts to $4 tax increase.

Secretary REGAN. We would be glad to work with the staff on that to try to figure out where the difference is between us.

Mr. RUSSO. Well, Mr. Secretary, I saw you on TV several weeks ago and you were talking with David Brinkley about the problems we were having with the budget. One of the things brought out in that discussion was that the budgets that you proposed have not been accepted by your own party in the Senate.

Your comment was, well, they ought to try ours. I thought that was kind of interesting because for the last 2 years we have tried yours, and in the last 2 years what we have found is that we have increasing deficits as a result.

Do you think that the fact that the Republican leadership in the Senate has tried the President's program over the last 2 years and has seen the deficits go through the roof, do you think that may be a reason why they were not willing to try for the third year?

Secretary REGAN. I do not think you have tried the President's budget over the last 2 years. I think he submitted budgets that have not been adopted by the Congress. They have been modified, they have been added to, some things subtracted from. I do not think that ours have been adopted.

In addition to which, I come back to something that we have testified to in 1982, and I am willing to do it again in 1983. You are trying to tag us with not having predicted the recession and then having caused the recession. Yet we know the recession started in July of 1981 and our program was not enacted in July of 1981. So we can hardly be tagged with having caused the recession.

Mr. RUSSO. Well, I just find it interesting that Gramm-Latta 1, Gramm-Latta 2, and all of the things that have taken place over the last 2 years, that you can say the President's program was not enacted. I find it difficult to believe, but maybe the American people will be the ultimate judges of that.

Do you know, Mr. Secretary, why the financial community or our business leaders are not making a lot of noise about deficits, as they did in the days of Jimmy Carter, when they thought a $30 billion deficit was going to sink the economy? And today these business leaders and financial people are not hammering away on reducing the deficit. They do a few little things. But they do not make the clamor.

Any particular reason for that?

Secretary REGAN. I think they have been making quite a clamor, as I hear what the Chamber of Commerce is saying. There has been a full-page ad taken out by former Secretaries of the Treasury together with Wall Street leaders. They had all kinds of signatures on that.

I do not know how much more they have to do to get their message across. They are concerned about deficits. The world is concerned about our deficits. Mr. Guarini read to me the BIS concern. We heard it at Williamsburg. Everyone is concerned with our deficits, including us.

Mr. RUSSO. Thank you, Mr. Secretary.

Chairman ROSTENKOWSKI. Mr. Secretary, you continue to resist any thought of balancing your proposed 1984 spending reductions with any revenue. It seems clear now, Mr. Secretary, that even the Senate is not fully supportive of the President's suggestion that the deficit be addressed through spending cuts alone.

Why can we not, in a spirit of bipartisanship, signal our willingness today to talk about developing a package of revenue-raising measures for 1984? Mr. Secretary, I am very concerned with what might happen to interest rates. I listened for an hour and a half last week to some of the most brilliant investors that I know, each of whom expressed their disappointment in both the administration and the Congress for not joining forces to do something about the revenues base.

Secretary REGAN. Well, Mr. Chairman, as you know, there is a difference of opinion here as to how we can prolong this recovery, and those very gentlemen who are talking about this, if we were to raise taxes, let us say $50 or $100 billion, I suspect you would have them lined up outside the door, protesting the type of taxes that you would be suggesting to increase as being counterproductive.

I think that almost any type of tax that I could think of at the current moment would be counterproductive in trying to get the recovery started. That is why I am reluctant to join with you at this particular moment.

Chairman ROSTENKOWSKI. Don, let me just say that unless we do something on a coordinated, cooperative basis, that interest rates will increase, and housing starts and auto sales will decline. In my opinion, the depressive effect on business investment and the recovery will be disastrous.

Given the absence of a budget resolution, I am hopeful that we can at least establish the guidelines for a bipartisan effort, if not with the administration then at least in Congress.

However, I cannot agree with your conclusions that some substantial revenue increases would not help more than deter the economic recovery.

Mr. Matsui will inquire.

Mr. MATSUI. Thank you, Mr. Chairman.

Mr. Regan, you have indicated in the last 2 hours that you are against putting a cap on the third year, that you are against doing anything with indexing except allowing it to go into effect in 1985. You will not give us a list of priorities in terms of possible new taxes for 1984, even if the budget resolution process works and requires between $9 and $12 billion in additional revenues.

Let us consider some of the taxes that are still scheduled to be phased in from the 1981 Tax Act. Many of the tax provisions were not part of your original program. Your original program was ACRS and it was the 3-year tax cut of 30 percent, down to 25.

To be phased in is a net interest exclusion for income, with estimated annual revenue losses of $3 billion. Would you consider repealing or freezing this provision in the out years?

Secretary REGAN. Which one is that?

Mr. MATSUI. That would be the net interest exclusion from income.

Secretary REGAN. Well, it depends upon what you are talking about in terms of——

Mr. MATSUI. The portion still scheduled to be phased in.

Secretary REGAN. Well, again, this net interest, it depends upon where you are talking about there. Remember that part of what you are talking about here affects automobile sales. You are also talking about retail sales. At this particular time, Mr. Ioacocca was in my office just yesterday talking about how to increase automobile sales.

You see, if you exclude interest——

Chairman ROSTENKOWSKI. Did he recommend that we raise the gasoline tax by 25 cents?

Secretary REGAN. No, he was not recommending that.

Chairman ROSTENKOWSKI. He did not? That is surprising. I thought he was recommending that.

Secretary REGAN. No. We were talking about how to sell automobiles.

Mr. MATSUI. Mr. Secretary, let me ask you about another tax provision. We are scheduled to increase the charitable deduction for nonitemizers. Would you consider freezing that at its current level? It will have a revenue loss potentially of between $2.5 and $4 billion a year when phased in.

Would that be something that you would be willing to put on the bargaining table so we can look at that?

Secretary REGAN. Are you going back to what the chairman proposed on some of these freezes of tax reductions earlier? Is that the list you have?

Mr. MATSUI. These items are all scheduled to be phased in. While they are in law under the 1981 Tax Act, they still are to be phased in. We are going to increase the charitable deduction for nonitemizers.

Secretary REGAN. Well, as I suggested earlier in my testimony, we have these figures for our contingency taxes. If there are things that are better than our contingency tax that can be enacted this year for being effective in 1985, we would certainly be glad to talk to you about those items.

Mr. MATSUI. Although we may pass the cap out of the House, I do not think it will become law. That is my feeling. I think, however, we are going to have to come up with a second tax bill because the financial markets will probably panic, just as they did in August 1981. And we could well be sitting down in September trying to come up with additional revenues in the out years. And that is why I am asking these questions.

We are going to increase, for example, the exclusion for the estate and gift taxes in the out years. And it was enacted in 1981, as it was part of the bargaining process that developed between the Senate, the House, and the White House. This estate and gift tax could cost us $2 billion a year in revenue losses.

Would you consider freezing it at the current levels?

Secretary REGAN. No. I think on that particular one I would be very careful, for the simple reason that people have already gone on for a lot of estate planning that you would undo. They are banking on that at this particular moment.

Mr. MATSUI. How about the tax relief for foreign-earned income which remains to be phased in? I think it is now phased in at $75,000. Now, would you have any problems with perhaps not implementing it further?

Secretary REGAN. Yes, I would have a lot of problems with that. I will tell you what the problem with that one is right now. We are trying to get our trade deficit down. We need Americans abroad working in order to help reduce that trade deficit, and we have given them the tax incentive. I would not want to withdraw it.

Mr. MATSUI. OK. What about the business tax relief scheduled through the additional changes of the ITC and the depreciation rules? With the phase in, the amounts will be greater in the out years.

Secretary REGAN. Again, I think we need that. One of the big things we are talking about is industrialization, industrial policy, things of that nature. You cannot make us more productive if you do not give incentives to do it, and I think that again that would be counterproductive.

Mr. MATSUI. So you are basically saying that the only one that you will consider is the charitable deduction for nonitemizers, right? That appears to be the only one that you would put on the bargaining table.

Secretary REGAN. What I just said is that we would be willing to talk about this whole list on a give-and-take basis. But at the present moment I do not see how. Most of these I think would be counterproductive.

Mr. MATSUI. If we did freeze all of these provisions, it would result it $9 billion a year in additional revenues in the out years.

Chairman ROSTENKOWSKI. Mr. Secretary, the list to which Mr. Matsui is referring is the tax freeze that I recommended. I am sure that I do not need to remind you that the list of proposed tax freezes does not cover items that we talked about in the first stage of negotiations on the 1981 tax reduction bill. All that we were talking about then was savings, investment, and productivity.

Secretary REGAN. We got all three of them. Do you realize that we had more investment in 1983 in the first 6 months than we had in all of 1982, and yet 1982 was one of the largest years of investment there ever was? We had more venture capital——

Chairman ROSTENKOWSKI. Mr. Secretary, that was a result of the IRA and Keogh expansions that the Democrats insisted be included in your tax package.

Secretary REGAN. The IRA's and the Keogh's were very helpful in the savings pool. But we still have a lot more than IRA's and Keogh's being invested. So what I'm saying is that we have gotten

more productivity, we have gotten more savings, we have more investment. I think we should stick with those.

Chairman ROSTENKOWSKI. I was under the impression that savings was down.

Mr. Secretary, I am afraid that we will have to answer a couple of rollcalls on the House floor. Consistent with your usual presentation, you have been quite informative and cooperative. I hope that you will go back with your staff and discuss the possibilities of a unified effort to address the deficit. The committee would appreciate that very much. The committee stands ready to cooperate.

The committee will stand adjourned.

[Whereupon, at 1:20 p.m., the hearing was adjourned.]

O